STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of Consumers Energy Company for authority to increase its rates for the generation and distribution of electricity, and for other relief.	)))))	Case No. U-16794

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on March 30, 2012.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before April 13, 2012, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before April 24, 2012. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Sharon L. Feldman

Digitally signed by Sharon L. Feldman
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Date: 2012.03.30 12:03:05 -04'00'

Sharon L. Feldman
Administrative Law Judge

March 30, 2012
Lansing, Michigan

S T A T E O F M I C H I G A N

MICHIGAN ADMINISTRATIVE HEARING SYSTEM

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

Issued and Served: March 30, 2012

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MICHIGAN ADMINISTRATIVE HEARING SYSTEM

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On June 10, 2011, Consumers Energy Company (Consumers) filed a rate application requesting a $195 million revenue increase, and other relief. The application relies on an October 1, 2011 through September 30, 2012 projected test year. The most recent rate case order for Consumers was issued by the Commission on November 4, 2010, in Case No. U-16191 (November 4 order).

At the July 18, 2011 prehearing conference, Staff, Consumers, and potential intervenors appeared.[1] Intervention was granted to the Michigan Department of the Attorney General (Attorney General), the Michigan Environmental Council and the

[1] No one appeared to present comments under Rule 207 of the Commission's rules of practice and procedure.

Natural Resources Defense Council (MEC/NRDC), Michigan Community Action Agency Association (MCAAA), the Municipal Coalition, Energy Michigan, the Association of Businesses Advocating Tariff Equity (ABATE), Hemlock Semiconductor Corporation (Hemlock), Midland Cogeneration Venture Limited Partnership (MCV), The Kroger Company (Kroger), Michigan State Utility Workers Council, and Phil Forner.[2] At the prehearing conference, the parties agreed to a schedule meeting the time limits of MCL 460.6a.

On September 13, 2011, the Commission issued an order jointly in this docket and several other dockets, acknowledging that common issues had arisen regarding the appropriate accounting treatment of certain recent tax changes, including the Patient Protection and Affordable Care Act and recent revisions to Michigan's tax structure. The Commission provided for comments and reply comments regarding proposals for the deferred accounting treatment for the re-measurement of deferred tax balances resulting from the new laws. The Commission's subsequent order addressing the deferred accounting treatment was issued in the joint docket on February 15, 2012.

On October 20, 2011, the Commission issued an order directing Consumers to file its proposed self-implementation tariffs by November 17, 2011, providing the opportunity for other parties to respond by November 21, 2011, and directing the ALJ to conduct an abbreviated hearing on November 22, 2011. In accordance with the established schedule, Consumers filed the testimony and exhibits of Ronn J. Rasmussen, the company's Vice President- Rates and Regulation. Responses to

[2] On July 28, 2011 and August 1, 2011, the Staff and consumers respectively filed applications for leave to appeal the ALJ's ruling on Mr. Forner's late-filed petition for intervention. In its October 4, 2011 and December 20, 2011 orders, the Commission denied Mr. Forner's petition to intervene, and denied his request for rehearing of that denial.

Consumers' self-implementation proposal were filed by the Staff, ABATE, Hemlock, and the Municipal Coalition. Mr. Rasmussen testified at the hearing and was cross-examined. Following the hearing, the Commission issued an order on December 6, 2011, which found good cause to limit the rate relief the company could self-implement to $118 million, provided for the rate design to be used, and directed the company to file appropriate tariffs.

In accordance with the schedule established at the July 18, 2011 prehearing conference, Staff and intervenors filed testimony on November 15, 2011, and rebuttal testimony on December 2, 2011. Evidentiary hearings were held on five days between December 13 and December 19, 2011. 41 witnesses appeared for cross-examination or had their testimony bound into the record by agreement of the parties.

The parties filed briefs and reply briefs on January 24, 2012 and February 14, 2012, in accordance with the established schedule. The following parties filed briefs: Consumers, Staff, ABATE, the Attorney General, Energy Michigan, Kroger, Hemlock, MCAAA, MEC/NRDC, and the Municipal Coalition. The following parties filed reply briefs: Consumers, Staff, ABATE, the Attorney General, Energy Michigan, Kroger, Hemlock, MCAAA, MEC/NRDC, the Municipal Coalition, and the Michigan State Utility Workers Council.

The evidentiary record in this proceeding is contained in 1642 pages of transcript and 229 exhibits admitted into evidence. An overview of the record is presented below.

II.

OVERVIEW OF THE RECORD AND POSITIONS OF THE PARTIES

A. Consumers

Consumers reduced its requested revenue increase from the $195 million initially filed to $181 million in its brief. The utility's rate request is based on a jurisdictional rate base of approximately $7.7 billion, a return on equity of 10.7% with an overall cost of capital of 6.86%, and an adjusted net operating income of $414 million. Mr. Rasmussen testified that approximately $145 million of the company's requested rate relief is attributable to the increased rate base resulting from the company's increased investment in Michigan, including required environmental compliance expenditures, generation and distribution reliability expenditures, and smart grid investments.[3] He attributes the remainder to the company's updated sales forecast, which he testified reflects the impact of sales associated with retail open access ("ROA"). Mr. Rasmussen testified that the company's O&M expense request for the projected test year (approximately $650 million) is $34 million below the level approved in Case No. U-16191, due to capital investments, productivity increases, and savings achieved through collective bargaining agreements. The company is also seeking future ratemaking treatment for various categories of expenses, including a revenue decoupling mechanism and an uncollectible expense tracker, other accounting approvals, and various tariff changes.

[3] Mr. Rasmussen's testimony is transcribed at 3 Tr 87-151.

Consumers presented the testimony of 17 witnesses, and 72 exhibits. Mr. Rasmussen presented an overview of the company's filing as discussed above; Erin A. Rolling, Senior Rate Analyst, presented testimony on the revenue requirements calculation, including rate base and adjusted net operating income, and required schedules; James R. Anderson, Executive Manager-Electric Asset Management, testified regarding distribution system capital and operating expense requirements; David B. Kehoe, Director of Staff-Electric Generation, and Nancy A. Popa, Manager of Environmental Services, testified regarding the company's generation system capital and operating expense requirements; David F. Ronk, Director-Electric Transactions and Resource Planning, testified regarding the planned operations of the Energy Supply department; Kenneth C. Jones, Assistant Controller, testified regarding Corporate Services expense projections, depreciation expense, and accounting issues related to the Clean Coal Plant and Smart Grid/AMI; Herbert Kops, Director-Employee Benefits, testified regarding employee and retiree benefits and other employee compensation issues; Maureen K. Trumble, Director-Smart Grid, Stephen T. Hirsch, Principal Business Support Consultant, and Frederick R. Merry, Principal Financial Analyst, testified regarding AMI/Smart grid analyses and plans; Leslie E. Roth testified regarding Business Technology Solutions capital and expense projections; Theodore J. Vogel testified regarding projected tax expenses and the impact of changes in tax laws; Dhenuvakonda V. Rao, Executive Director-Financial Forecasting and Planning, presented testimony regarding the capital structure and required rates of return; Lincoln D. Warriner, Senior Business Support Consultant—Lead, presented the company's sales and revenue forecasts; Eric J. Keaton, Senior Business Support Consultant sponsored the company's cost of service study; Benjamin M. Ruhl, Senior Rate Analyst, sponsored the primary rate design, tariff and rule changes sought by the company, as well as the company's proposed RDM and uncollectible expense tracker.

B. <u>Staff</u>

Staff's filing recommends a revenue deficiency of $39 million on a jurisdictional basis, based on a return on equity of 9.95%. Staff's briefs recommend additional adjustments. Staff presented the testimony of 14 Staff members, and 18 exhibits.[4] Kevin J. Krause and Brian A. Welke, Auditors with the MPSC, were principally responsible for presenting Staff's revenue requirement calculations, relying on testimony from several other Staff witnesses for various components. Jill M. Rusnak and Charles J. Reasoner, both Public Utilities Engineers, testified regarding generation and electric distribution capital and O&M expense projections; Patrick L. Hudson, Manager of the Smart Grid Section of the MPSC's Electric Reliability Division, and Nicholas M. Evans, Public Utilities Engineer in the same section, testified regarding the AMI/Smart Grid plans and costs; Yerva C. Talbert, Auditor for the MPSC, testified regarding the appropriate treatment of taxes; Mark J. Pung, Departmental Analyst, presented testimony on Staff's revenue estimates. Kurt D. Megginson, Financial Specialist, presented Staff's analysis of the cost of equity; Kavita R. Bankapur, Financial Analyst, presented testimony regarding the capital structure and cost rates for the non-equity components. Daniel Birkam, Auditor for the MPSC, testified to Staff's position regarding certain accounting issues, including the canceled Clean Coal Plant and AMI/Smart Grid costs; Katie J. Smith, Economic Analyst, presented Staff's

[4] The testimony of all Staff witnesses is transcribed in volume 5 of the record.

recommendations regarding a revenue decoupling mechanism; and Dr. Nicholas I. Nwabueze, Director of the Regulated Energy Division, testified to Staff's recommendations regarding company-proposed tracking mechanism. Staff's cost of service study was presented by Charles E. Putnam, Departmental Analyst, while Mr. Pung presented testimony on rate design, tariff and rule changes.

C. Attorney General

The Attorney General recommends a revenue sufficiency of $149 million based on the testimony of his witness, Sebastian Coppola, independent consultant and President of Corporate Analytics, Inc., and 34 exhibits. Mr. Coppola recommends significant reductions to the company's capital and O&M expense projections, and modifications to the company's sales projections. He further recommends use of an alternative capital structure based on the capital structure of CMS Energy with a return on equity of 10%, and a return on equity of 9.7% if the Commission uses the traditional approach to determining the company's capital structure. The Attorney General also makes recommendations regarding the proposed revenue decoupling mechanism and tracking mechanisms.

D. MEC/NRDC

MEC/NRDC presented the testimony of Pamela H. Richards, Senior Consultant for La Capra Associates, and George E. Sansoucy, owner of his own consulting firm George E. Sansoucy, P.E., LLC, addressing issues primarily relating to the company's operation of its coal plants. MEC/NRDC seeks reductions in the company's capital and O&M expense projections for its coal-fired units, opposes the company's proposal to recover Clean Coal Plant costs through an amortization, and seeks remedies to require the company to reduce its line losses. MEC/NRDC presented 68 exhibits. MEC/NRDC does not present a revenue requirements calculation, but does make specific recommendations regarding projected capital and O&M expenditures in the generation and distribution categories.

E. ABATE

ABATE presented the testimony of James T. Selecky, Managing Principal of Brubaker & Associates, Inc., on cost of service allocation and rate design issues, as well as the RDM and Clean Coal Plant costs. ABATE presented 19 exhibits. ABATE argues for the allocation of production and transmission costs based on a "pure 4CP" allocation or "4 CP 50/25/25" allocation; proposes revisions to the allocation of customer assistance costs, residential skewing and rate discounts; makes proposals for the rate design of GPD rates by voltage level, recommends modification to the metal melting pilot, and makes recommendations regarding Rate GSG-2 rate design and tariff. Regarding revenue requirements, ABATE opposes recovery of AMI/Smart Grid and Clean Coal Plant costs, and opposes the revenue decoupling and uncollectible expense tracker proposals.

F. Municipal Coalition

The Municipal Coalition presented the testimony of Curtis L. Holt, City Manager for the City of Wyoming, and two exhibits. The Municipal Coalition is concerned with the level of cost increases facing its members since the rate classes were consolidated. It urges the Commission to establish a separate class for municipal customers with rates based on the cost of service for those customers. In the meantime, the Municipal Coalition urges the Commission to continue the municipal pumping credit established in Case No. U-15245, restored to its initial level, and to use the 4 CP method for allocating costs based on peak demand. The Municipal Coalition also argues that the Commission should restrain Consumers rate of return on equity to the level advocated by Staff, and deny any rate increases.

G. MCAAA

MCAAA presented the testimony of Ronald C. Callen, consultant with Public Law Resource Center PLLC, and William A. Peloquin, C.P.A., and ten exhibits. MCAAA asks the Commission to adopt “regulatory remedies” to protect ratepayers from what MCAAA alleges is significant imprudence on the part of the company in giving up claims based on the failure of the federal government to adhere to its contractual requirement to accept spent nuclear fuel for disposal. MCAAA also makes proposals regarding the company’s forestry and Clean Coal Plant expenses, as well as the PSCR base.

H. Hemlock

Hemlock is the only customer currently taking service under Rate E-1; it also receives service under Rate GPD. Hemlock presented the direct and rebuttal testimony of its consultant, Michael Gorman, Managing Principal of Brubaker & Associates, Inc., and one exhibit. Hemlock urges the Commission to adopt the 4CP 50/25/25 method of allocating production costs, and to use the 12 CP method of allocating transmission costs. Hemlock opposes the company’s and Staff’s proposed revenue decoupling mechanisms, and opposes trackers. Hemlock also has concerns regarding the company's proposed rate design for Rate GPD and Rate GSG-2.

I. <u>Kroger</u>

Kroger presented the testimony of its consultant, Neil Townsend, Senior Consultant for Energy Strategies, LLC, and two exhibits. Kroger generally supports the utility's cost of service allocations, but favors the increased allocation of costs based on peak demand. Kroger also urges the elimination of subsidies from rates, and opposes continuation of the ECIP trackers. Kroger presented one exhibit. Kroger recommends modifications to the rate design for Rate GPD, and opposes Consumers' and Staff's proposed revenue decoupling mechanisms, with its own recommendations regarding exemptions from the RDM. Kroger also supports ABATE's recommendations regarding the allocation of customer assistance costs and the allocation of residential skewing amounts and other rate discounts.

J. <u>Energy Michigan</u>

Energy Michigan presented the testimony of independent consultant Alexander J. Zakem, independent consultant, and his Exhibit EM-1. Energy Michigan opposes the company's proposed revenue decoupling mechanism, and argues that power supply revenue credits or surcharges should not be assigned to ROA customers.

K. <u>Utility Workers Council</u>

The Utility Workers Council did not present testimony in this case, but filed a reply brief supporting the Attorney General's and ABATE's arguments regarding the

Smart Grid/AMI program, urging the commission to find that the company failed to support the AMI expenditures.

L. Overview

The positions of the parties are discussed in greater detail below. Section III addresses the choice of test year to be used in setting rates. Section IV addresses the rate base, including the appropriate net plant and working capital amounts. Section V addresses the rate of return, including the appropriate capital structure to use in setting rates and the individual cost elements to use in determining the overall cost of capital. Section VI addresses the test year adjusted net operating income, including disputes among the parties over sales and revenue estimates to use and the appropriate operating expense projections. Section VII discusses other revenue requirements-related issues, including accounting proposals regarding AMI/Smart Grid, the Clean Coal Plant, proposed revenue decoupling mechanisms, and whether various "tracker mechanisms" should be adopted. Section VIII summarizes the revenue requirement analysis. Section IX addresses the cost of service studies and cost allocation issues raised by the parties. Section X addresses rate design, including the company's proposed changes, the requirements of MCL 460.11, and the allocation of subsidies and rate discounts, as well as proposed tariff changes.

The testimony of each of the witnesses is discussed in more detail below, in conjunction with the positions of the parties.

III.

TEST YEAR

A test year is used to establish representative levels of revenues, expenses, rate base, and capital structure for use in the rate-setting formula. The parties and the Commission may use different methods in establishing values for these components, provided that the end result is a determination of just and reasonable rates for the company and its customers.

Consumers filed its rate application using the projected test year October 1, 2011 to September 30, 3012. While some parties dispute various components of the company's projections, no party proposed using a different test year to set rates. In the absence of dispute, this PFD recommends that the Commission adopt the October 1, 2011 through September 1, 2012 test year.

IV.

RATE BASE

Rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements.

A. Net Plant

Net plant is the primary component of rate base, and its key elements are total utility plant--plant in service, plant held for future use, and construction work in progress (CWIP)--less the depreciation reserve, which includes accumulated depreciation, amortization and depletion.

Consumers Energy presented testimony on its projected capital expenditures broken down into categories including fossil and hydro generation plant requirements; distribution system requirements; energy supply requirements; BTS requirements and Smart Grid/AMI. Also, the company's filing includes in rate base the unamortized balance of its Clean Coal Plant expenses under the company's proposal to recover those costs over a three-year period. The disputes among the parties involve several of the company's projected capital additions for the test year, as well as the treatment of Clean Coal Plant costs.

An initial dispute between Staff and the company involved Staff's approach to determining the company's net utility plant. The company projected plant balances starting with its actual balances as of December 31, 2010. As Staff witness Mr. Krause explained, Staff's audit indicated that the company was not increasing its plant balances as quickly as it projected, so Staff used the actual September 30, 2011 higher balances for Plant in Service and Plant Held for Future Use, and lower balances for Construction Work in Progress as the starting base for its projections for the test year.[5] Staff's ending CWIP balance reflects its additional adjustments to the company's capital

[5] See 5 Tr 1076-1078.

expenditure projections. Staff argues that its approach to projecting utility plant for the test year is reasonable, specifically responding to Mr. Rasmussen's testimony:

> [D]elays in construction are commonplace. However, it is just as likely that projects will slip out of the projected test year based on construction delays as it is that they will slip into the test year. While it is impossible to project the amount of construction delays that may slip beyond the test year, it is reasonable to assume the amount will be the same as the amount of slip that occurred at the beginning of the test year. Therefore, Staff recommends that project delays not be considered in the adjustments to CWIP.[6]

The company initially challenged this approach. Mr. Rasmussen testified in his rebuttal testimony:

> The Company does not disagree that the level of actual expenditures through September 2011 are lower than what is reflected in the Company's request in this filing. However, these differences are an issue of timing, i.e., the Company's most up-to-date projections indicate that the actual "underspend" of 2011 capital dollars through September 30, 2011 will be made up during the test year in this case. This projected level of increased spending through September 30, 2012 is in addition to the projected level of expenditures identified in the Company's original filing.[7]

In its initial brief, although citing Mr. Rasmussen's testimony, the company indicates that it accepts Staff's approach, and focuses its arguments regarding capital expenditures on the 2012 projections Staff and intervenors challenged, as well as the Clean Coal Plant costs Staff excluded from net plant.

Nonetheless, the company argues that to be consistent with the use of the September 30, 2011 plant balances, the working capital calculation should also be updated. It therefore argues that the Commission should increase the company's originally-filed working capital amount of approximately $604 million to $772 million, as

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[6] See Staff reply brief, pages 25-26.
[7] See 3 Tr 106.

shown in Appendix B to its initial brief, based on Ms. Rolling's rebuttal testimony. Staff disputes that the working capital calculation should be updated.[8]

Based on the discussion above, this PFD concludes that Staff's approach is reasonable to determine test year net plant, with additional adjustments for the projected test year discussed in subsections 1 through 6 below. The dispute regarding the working capital allowance is discussed further in subsection B below.

1. <u>Fossil/Hydro Generation</u>

The company projected total capital expenditures on its fossil and hydro generation plant of $244 million and $386 million for the first nine months of 2012.

Mr. Kehoe testified for Consumers Energy regarding the company's fossil and hydro generation capital requirements, including planned capital expenditures summarized on Exhibit A-29.[9] Mr. Kehoe testified that the major drivers of the increased capital expenditures in this category are the Clean Air Act and plant reliability. He testified that the company has a balanced strategy to achieve environmental compliance in a cost effective manner to mitigate the rate impacts on customers, including both the investment in emissions control technology and the purchase of emission allowances from the market when possible.[10]

He discussed relevant environmental regulations, including the Michigan Mercury Rule, which he testified requires control on a unit-by-unit basis, and regulatory changes the EPA is considering under the Clean Air Act. He testified that EPA is considering

[8] See Staff brief, page 23-24.
[9] See 6 Tr 1316-1326; 1343-135.
[10] See 6 Tr 1317.

revising emission limits for SO_2 and NOx by replacing the Clean Air Interstate Rule(CAIR) with the Clean Air Transport Rule (CATR), and revising mercury limits and limits on other hazardous air pollutants (HAPs) by adopting the Electric Generating Unit Maximum Achievable Control Technology (EGU MACT).[11]

Reviewing the line items for environmental compliance in his Exhibit A-29, he described the following expenditures for 2011 and the first nine months of 2012. Starting with line 13 of Exhibit A-29, he testified:

> PM2.5 - PE 24 - $125.6 million includes capital expenditures related to compliance with [CAIR] of March 2005 – which is for the control of fine particulate matter less than 2.5 microns ("PM 2.5"). This account includes the expenditures necessary to further control SO_2 and NOx emissions.[12]

He further testified regarding what he referred to as the "PM 2.5 dollars":

> In 2009 and 2010 Consumers Energy invested in SCR equipment at Campbell 2, as well as low NOx burners at Weadock 7 & 8. In 2010 – 2012, Consumers Energy has invested in SCR and spray dry absorber (SDA) equipment at Campbell 1 - 3 and Karn 1 & 2.[13]

Turning to line 14 of Exhibit A-29, he explained:

> Mercury – PE 24, - $159.0 million, includes capital expenditures necessary to reduce mercury emissions to meet existing State and pending Federal mercury regulation.[14]

He further testified regarding what he referred to as the "Mercury dollars", that the expenditures are to comply with the Michigan Mercury Rule as follows:

> In 2009 – 2011, Pulse Jet Fabric Filters ("PJFF") and Activated Carbon Injection ("ACI") will be installed on Karn Units 1 & 2. In 2010-2012, PJFF and ACI will be installed on Campbell Unit 1 – 3.[15]

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[11] See 6 Tr 1316.
[12] See 6 Tr 1319
[13] See 6 Tr 1325.
[14] See 6 Tr 1319.
[15] See 6 Tr 1325.

Turning to line 15 of Exhibit A-29, he testified:

> 316b – PE24 - $1.9 million, includes capital expenditures related to the cost of capital projects at fossil generating units mandated by Section 316(b) of the Clean Water Act which requires that the location, design, construction and capacity of cooling water intake structures reflect the best technology available for minimizing adverse environmental impact. This account includes the expenditures necessary to minimize the adverse impact of drawing fish into the plant's cooling system.[16]

And regarding line 16 of Exhibit A-29 he testified:

> Resource Conservation and Recovery Act (RCRA) & Other Environmental – PE 24 -$3.9 million, includes capital expenditures related to the purchase of equipment for the Environmental group and compliance with the Environmental Protection Agency Solid Waste Disposal Act.[17]

Regarding plant reliability expenditures, Mr. Kehoe testified to the planned non-environmental work by unit for the Campbell, Karn, Weadock, Cobb, and Whiting units, as well as Ludington, shown on lines 2 to 11 of Exhibit A-29. For Karn unit 1, he testified that:

> In 2011, Karn Unit 1 will replace the superheat lower deck, install a condenser cleaning system, oil filter and water separator and replace the feed water control valves. In 2012, boiler tubes will be inspected and replaced.[18]

For Karn unit 2, he testified that SCR catalyst work would continue into 2012,[19] and for both units 1 and 2, testified that ash pond improvements would be made and a new liquid urea system will be installed.[20] For Ludington, he testified that the company will begin to invest in a major overhaul and upgrade, with the first unit upgrade to be completed in 2014 and the sixth and last unit upgrade to be completed by 2019. He

[16] See 6 Tr 1319.
[17] See 6 Tr 1319.
[18] See 6 Tr 1321.
[19] It appears that this SCR catalyst work is separate from the SCR work included in the environmental compliance costs, since there is no sheet identifying it in Exhibit A-53, but the record is not clear.
[20] See 6 Tr 1322.

testified these upgrades will increase Ludington's capacity by 300 MW, and are necessary for the following three reasons:

> First, this will be the second overhaul at Ludington since production began in 1973. Second, Ludington's operating license expires in 2019. Third, the relicensing process considers the safety and operating condition of the facility.[21]

Ms. Rusnak testified on behalf of Staff. She recommended two significant adjustments to the company's projected capital expenditures. First, she reviewed the company's proposed expenditures for environmental compliance, shown on lines 13 to 16 of Exhibit A-29, and responses to discovery and audit requests, and concluded that the company had not supported the proposed expenditures.[22] She testified that the environmental capital expenditures approved for recovery in this case should be limited to the company's actual expenditures through September 30, 2011, relying on Staff witness Mr. Krause to present the actual audited expenditures. She explained that Staff's recommendation is based on uncertainty as to the timing and extent of the company's obligations to comply with state and federal environmental laws, and the company's failure to provide a comprehensive environmental compliance strategy and details of past and planned expenditures for environmental compliance. She presented Exhibits S-10 through S-14 in support of her testimony, critiquing the company's responsiveness to Staff's request for additional information regarding the company's past and planned environmental expenditures. And she cited the Commission's November 4 order in Case No. U-16191, asserting that the company had failed to support its environmental cost projections as required by the Commission in that order.

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[21] See 6 Tr 1324.
[22] See 5 Tr 1165-1170.

Second, she reviewed the company's proposed expenditures for certain plants she characterized as "marginal", including the Cobb units 1 through 3 and the Whiting units 4 and 5, due to their uncertain status.[23] Exhibit S-7 contains information showing the age and capacity of these units. As of the time she filed her testimony, Ms. Rusnak explained, these plants were the most likely to be retired, and ratepayers should not be asked to pay for additional major spending at plants that are likely to be retired in the near future. On this basis, Ms. Rusnak recommended that the Commission limit the company's recovery to the amounts actually expended as of the date of Staff's audit, as explained by Mr. Krause and shown on Exhibit S-9, and that projected expenditures for 2012 be excluded from the net plant calculation.[24]

Ms. Richards testified on behalf of MEC/NRDC. She also took issue with the company's proposed environmental compliance expenditures, and with its proposed non-environmental capital expenditures for certain plants.[25] Her testimony also identified concerns with the quality of information provided by Consumers in discovery. She concluded that there is uncertainty associated with the timing and extent of the company's environmental compliance obligations. She further testified that the company had not performed sufficient analysis to support the reasonableness and prudence of its projections:

> The economic impact of complying with environmental regulations requires sufficient due diligence to compare the cost to comply with alternatives. Before the Commission approves recovery of further investment in CEC's units, there should be an accounting of the

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[23] See 5 Tr 1162-1165.

[24] Subsequently, as noted above, the company has announced plans to mothball these plants, along with Weadock units 7 and 8. Staff argues in its reply brief that the 2012 costs for the Weadock units should also be excluded from the projected net plant calculation.

[25] See 6 Tr 1465-1478.

> environmental, capital, fuel, and O&M expenses facing these units in order to determine whether it is better for ratepayers to continue investing in these units versus retiring them or pursuing a reduced output paradigm . . .
>
> Without a cost benefit analysis, without the kind of detailed information requested by the Commission in its order in the last rate case, and without an accounting of all of the costs associated with these units to determine whether it is better to invest further in these units or pursue other alternatives such as retirement or curtailment, CEC has not demonstrated that the expenses are accruing benefit to the customer.[26]

In supplemental direct testimony admitted by the ALJ on motion by MEC/NRDC, and over the objection of Consumers, she provided her analysis of additional information regarding proposed expenditures at the Karn and Campbell units obtained from Consumers in response to discovery requests.

Mr. Coppola testified for the Attorney General regarding the company's proposed generation capital expenditures.[27] He took issue with the overall level of the company's proposed capital spending in relation to what he characterized as "anemic" sales growth. He presented Exhibit AG-16 along with charts included in his testimony to show utilization rates at Karn units 3 and 4, and Ludington units 1 through 6, as well as certain combustion turbines, concluding that the company has significant under-utilized generating capacity.[28] He concluded that the Karn units 3 and 4 should or would likely be mothballed, and recommended a disallowance of $6.3 million based on his estimate of the amount the company proposed to spend on these units and the combustion turbines. Further, he recommended that expenditures to upgrade and expand the Ludington Pumped Storage Plant in conjunction with Detroit Edison be removed from rate base, based on his conclusion that the company had not adequately justified the

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[26] See 6 Tr 1474-1475.
[27] See 4 Tr 702-704, 706-717.
[28] See 4 Tr 702-712.

expenditures. His recommended adjustment included forecast expenditures for 2011 and 2012, as well as past expenditures from 2007 to 2010, or a total of $62.1 million.

Finally, he compared the company's actual capital expenditures to the company's forecast in Case No. U-16191, presented in his Exhibit AG-18. He testified that the company had projected in that case that it would expend $309.1 million in 2010, but only spent $247.2 million or 80% of the amount allowed in rates, and for the first six months of 2011, had projected capital expenditures of $158.2 million and is now proposing to spend less in 2011 on an annualized basis. Based on this review, he suggested that the company could be engaging in a purposeful strategy to gain higher rates. On this basis, he recommended that the Commission disallow 20% of the company's remaining fossil and hydro generation capital expense projections, after subtracting his earlier recommended reductions, or an additional reduction of $114.6 million, for a total reduction of $183.0 million.

Mr. Kehoe testified in rebuttal to Staff, MEC/NRDC and the Attorney General.[29] Regarding the company's proposed capital expenditures for the "marginal plants", Mr. Kehoe testified that on December 2, 2011, Consumers announced that it will operate the Company's seven smallest coal-fired units only through December 31, 2014, at which time they will be "mothballed".[30] The company refers to these seven units as the "seven classics", which include the marginal plants identified by Ms. Rusnak (Whiting units 1, 2 and 3, the Cobb units 4 and 5) and Weadock units 7 and 8. He testified that the company had concluded that installing air quality control systems on these units was

[29] See 6 Tr 1340-1354.
[30] "Mothballed" refers to removing the generating unit from operations for the present, but maintaining the unit in a physical state such that it can become operational at a future date if circumstances exist justifying such action. Kehoe, 6 Tr 1341.

not cost-effective. But he further testified that the company's filing in this case seeks recovery only of costs required to operate the plants safely and in compliance with environmental regulations until the planned mothballing in 2015.[31] He further testified:

> The Commission should approve the proposed capital and O&M expenditures because: 1.) in the near term, these sites will continue to produce competitively priced energy (based on modeling which was completed by Consumers Energy) through 2014. Consumers Energy calculates a small but significant benefit to our customers in continued operation of these units until 2015; 2.) continued operation until 2015 will insure system reliability and stability; and 3.) continued operation until 2015 will allow Consumers Energy to initiate a plan which minimizing [sic] the impact of these actions on all affected parties, including the completion of system impact studies that are required by Midwest ISO.[32]

Responding to Mr. Coppola's testimony, Mr. Kehoe testified that the company's forecast expenditures are based in part on scheduled outages, some of which will inevitably change due to contractor availability, parts availability, changes in emissions regulations, design changes, outage scope changes, changes in unit condition, changes in staffing, spot market prices, and budgets.[33] He testified that Mr. Coppola's proposed 20% reduction in capital spending should be rejected because it lacks a substantive basis and fails to identify any project or project expenditure that is questionable.

Regarding the Ludington upgrade, he testified that additional information had been provided in discovery indicating that the upgrades would improve efficiency, increase the plant's role as a clean energy source, and ensure it will continue to produce low-cost reliable electricity during peak periods.[34] He also testified that what appears to Mr. Coppola to be low utilization of the plant reflects the fact that the

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[31] See 6 Tr 1342.
[32] See 6 Tr 1342-1433.
[33] See 6 Tr 1348.
[34] See 6 Tr 1350.

utilization rate of the pumped storage facility is limited by the need to pump or refill the reservoir.[35] He further explained that the value of the plant is that it substantially reduces peak power costs, and testified that the company calculates the net present value of the Ludington upgrade to Consumers Energy's customers to be $726 million, with a comparable benefit to Detroit Edison's customers.

Ms. Popa also testified in rebuttal to Staff and the MEC/NRDC recommendations to exclude from net plant proposed capital expenditures on environmental compliance.[36] She testified that the "vast majority" of the capital expenditures for environmental compliance included in the company's case are for compliance with regulations that are final and certain. She further testified that where uncertainty exists, the company has minimized the level of expenditures to the maximum degree possible while still preserving the ability to achieve compliance when the rules do become final.

Regarding the PM 2.5 expenditures for Campbell and Karn, she testified that regulations regarding NOx and SO_2 are currently in effect under the Clean Air Interstate Rule (CAIR) that has been in effect since 2009. She testified that to date, compliance with CAIR has been achieved with previous installations of low NOx burners, Selective Catalytic Reduction (SCR) installed on Karn units 1 and 2 and Campbell unit 3 and increased use of low sulfur coal. She testified that further reductions would be achieved with the installation and use of an SCR on Campbell unit 2 and Spray Dry Absorbers (SDA) on Karn units 1 and 2 and Campbell unit 3, by the dates shown in Exhibit A-53.[37] While acknowledging that emission allowances could be purchased, she testified that

[35] See 6 Tr 1350-1351.
[36] See 6 Tr 1439-1451.
[37] See 6 Tr 1441. Exhibit A-53 is the company's discovery response ST-CE-11 contained in Exhibit S-13.

the company had evaluated this option, and that installation of the equipment not only provides compliance with current regulations, it "prepares the generating fleet for compliance with future regulations that require unit-by-unit controls."[38] She also indicated that expenditures identified on line 15 of Exhibit A-29 (for section 316b ,Clean Water Act compliance) have been postponed because the applicable regulations were not finalized in 2011 as expected, but are now expected in mid-2012.[39]

She further testified that the company had clearly described its approach to environmental compliance in Mr. Kehoe's direct testimony,[40] and provided "very detailed" and "very specific" information in response to Staff and MEC/NRDC inquiries.[41] She presented Exhibits A-53 through A-59 to establish for the record, the information that the company had previously provided. She also testified that in order to understand the company's compliance efforts, it is necessary to tie expenditures to a specific regulation.[42]

Specifically addressing Ms. Richards's testimony that the company's efforts to delay the implementation of EGU MACT regulations could correspondingly delay environmental compliance measures, she testified that Ms. Richards misinterpreted information presented by the company in Exhibit A-53. Ms. Popa contended that the exhibit shows that all fabric filters being installed are needed to achieve compliance with the Michigan Mercury rule, and will also play a part in achieving compliance with other federal rules such as National Ambient Air Quality Standards (NAAQS) and EGU

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[38] See 6 Tr 1441.
[39] See 6 Tr 1442.
[40] See 6 Tr 1443-
[41] See, e.g. 6 Tr 1443, 1445, 1448, 1449.
[42] See 6 Tr 1446.

MACT. Similarly, she testified, the Spray Dry Absorbers (SDAs) being installed will play a part in meeting the existing CAIR as well as anticipated EGU MACT, CASPR, and NAAQS.[43] Additionally, she testified that test year expenditures are not being made to comply with EGU MACT regulations, and the company's discovery responses so stated, but are being made to meet the existing Michigan Mercury Rule and CAIR.[44]

Specifically addressing Ms. Richards's testimony that the company has not done long term planning for environmental expenditures, she testified that Mr. Kehoe's testimony clearly describes the company's approach, and that the company has provided substantial additional materials to the parties in this case describing the reason for the air emission control equipment, the technology to be used and the necessary expenditures. She referred again to Exhibits A-53 through A-59, and indicated that the company has provided "a very comprehensive description of its overall compliance strategy including forecasting models, approach, costs and technologies."[45]

Mr. Rasmussen also testified on direct and rebuttal regarding the company's capital projections. Specifically addressing the Commission's order in Case No. U-16191, he testified that the Commission's request for evidence demonstrating the company's commitment to major capital projects and O&M expenses "is not entirely clear", and testifying that the company "is committed to making the investments that are described in its rate filings."[46] In his rebuttal testimony, he testified that:

> The individual witnesses addressing capital and O&M expenditures in this case provide well-reasoned justification for these expenditures in a clear and concise manner. These expenditure levels have undergone rigorous

[43] See 6 Tr 1446.
[44] See 6 Tr 1447.
[45] See 6 Tr 1447-1449.
[46] See 6 Tr 95-97.

> management review, and the Company's commitment to these expenditures has been articulated through the customer benefit discussion accompanying each witness's testimony. Where appropriate, each witness has provided additional details on new or incremental investment necessary to improve safety, reliability, or customer service levels.[47]

a. Environmental Capital Projections

Staff's brief argues that there are two compelling reasons for the Commission to adopt its environmental capital cost adjustments, because the regulations contain uncertainty or are still pending, and because the company did not adequately support the expenditures in this case.[48]

As to the first point, Staff notes that Ms. Popa's rebuttal testimony indicated that PM 2.5 is regulated under CAIR, in effect since 2009, but as of July 2001, CAIR was replaced by the CSAPR, which was stayed as of December 2011. The order of the U.S. Circuit Court of Appeals for the D.C. Circuit is attached to Staff's brief as Attachment A. Looking at the mercury regulations, Staff argues that EGU MACT regulation was not final when Staff submitted its testimony, but on December 21, 2011, EPA replaced CAMR, vacated in 2008, and argues that the company's proposed expenditure of $159 million for mercury for the first nine months of 2012 is premature since the company has not provided a strategy for compliance with this rule.

As to the second point, Staff cites the Commission's November 4 order in Case No. U-16191, addressing appropriate support for projected capital expenditures, and asserts that the company has not provided the information required by that order. Staff

[47] See 3 Tr 109.
[48] See Staff initial brief, pages 7-15.

characterizes Mr. Kehoe's testimony as essentially identical to the testimony provided in Case No. U-16191, and also takes issue with Mr. Rasmussen's testimony, which asserted that the order was not clear.[49] Staff's brief also critiques the company's responses to Staff's discovery and audit requests, arguing that the responses to the requests were inadequate, and that when asked for specific information, multiple times, the company was less than fully responsive.

Reviewing Ms. Popa's rebuttal testimony, and the exhibits she cited, Staff argues that the Company has still not provided any detailed breakdowns for the requested expenditures, explaining specifically what the dollars will be spent on, or what the dollars received in past cases for similar projects have been spent on. See Staff brief at page 13 and n 2, addressing exhibits identified by Ms. Popa, including NRD-49, and Exhibits A-53-A59.

Staff's brief also addressed Mr. Rasmussen's rebuttal testimony:

> [T]he company has had ample opportunities to respond to Staff discovery requests to provide adequate detail and chose not to. However, Mr. Rasmussen responded in Rebuttal to Staff's claims as follows:
>
> > These expenditure levels have undergone rigorous management review, and the Company's commitment to these expenditures has been articulated through the customer benefit discussion accompanying each witness's testimony. [3 Tr 109.]
>
> The Case No. U-16191 Order gave examples of what the Company could do to provide more information. The fact that, as Mr. Rasmussen claims, there was "rigorous management review" . . . means nothing if no detail or additional information is provided in this case for Staff and the other parties to determine the reasonableness and prudency of the required expenditures. No where in rebuttal has Mr. Rasmussen pointed to any more hard data or supporting evidence of the requested expenditures

[49] See Staff initial brief, pages 10-12, also citing Rasmussen, 3 Tr 95-97.

> provide din its original filing, because there is none. While the Company may believe it has thoroughly reviewed these expenditures, it has not provided enough information in this case for other parties to come to the same conclusion.[50]

Consistent with Ms. Rusnak's testimony, Staff's brief emphasizes that this rate case is not the company's last chance for recovery, indicating that the company has filed rate cases each of the last 3 years.

MEC/NRDC also argues that Consumers has not met its burden of proof regarding the environmental capital projections. Reviewing the applicable standards in its initial brief at pages 1-4, including citation to the Commission's November 4 order in Case No. U-16191, MEC/NRDC argues that the environmental capital expenditures are not supported by a demonstration that the expenditures are the most prudent course of action. Relying on Ms. Richards's testimony, MEC/NRDC argues that prudent industry practice calls for the company to evaluate whether the generation requirements represented by some or all of the units could be met more cost-effectively with alternatives, such as optimizing use of other Consumers resources, increasing use of other resources available through the MISO market, increased demand side management or renewable resources.[51] MEC argues that Consumers must demonstrate that its significant investment in retrofitting each of the Karn and Campbell units is justified, on a unit by unit basis, given the age of the units and the likely operations, maintenance, and fuel expenses that will be required at each in future years.

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[50] See Staff initial brief, pages 11-12.
[51] See MEC/NRDC brief, pages 17-28.

MEC/NRDC also relies on Ms. Rusnak's testimony, arguing that Consumers had not presented a strategy for how it planned to spend money for environmental compliance, and that Staff and MEC/NRDC made multiple attempts to get more information on the company's proposed expenditures.

MEC/NRDC also discusses what they characterize as information turned over late in the discovery process, arguing that the "August 2011 Balanced Energy Initiative" in Exhibit NRD-36 summarizes conclusions of the company's analysis, but does not provide the detail and basis underlying those conclusions, and does not demonstrate that the proposed expenditures are part of a prudent and low cost resource plan.[52]

In addressing its proposed environmental capital expenditures in its brief, Consumers relies heavily on Ms. Popa's testimony, emphasizing her testimony that the vast majority of the capital expenditures included in the company's case are for compliance with regulations that are final, and where uncertainty exists, that the company has minimized the level of expenditures to the maximum degree possible, while still maintaining the ability to achieve compliance when the rules become final and certain.[53] Consumers asserts that it has a "well thought out, comprehensive plan to comply with all environmental regulations, a plan detailed in the testimony of Company witness Nancy A. Popa", and that if Staff and MEC/NRDC adjustments are adopted, the company will be unable to recover the costs required to meet the environmental regulations at many of its generating plants.

[52] Brief at 26-27.
[53] See Consumers initial brief, pages 10-19.

Addressing Ms. Richards's testimony that the company has not demonstrated benefits to the company's customers from the environmental capital expenditures, Consumers argues that compliance with the applicable laws is necessary for continued operation of the generating units, and that additionally, the investments will decrease the environmental impact of electricity production and thus improve the quality of life for customers.

Consumers' brief and reply brief further address what it claims is a misunderstanding by Staff and the MEC/NRDC regarding the applicable environmental regulations. Consumers argues that Staff assumes PM 2.5 as shown on Exhibit S-10 is the only PM 2.5 regulation, while CAIR and CSAPR regulate NOx and SO2, which are "precursors" of PM 2.5. Consumers further argues that the mercury expenditures are related to the Michigan Mercury Rule, which is final. Consumers asserts: "Environmental regulations can take years of lead time for designing, permitting, engineering, procuring, and constructing. The alternative to spending prior to the compliance date is shutting down the generating units until they are retrofitted to comply with the regulation."[54] Regarding Staff and MEC/NRDC arguments that the company has not met its burden of proof to establish the reasonable and prudence of its expenses, the company argues:

> In reality, Staff was provided with:
>
> - Cash flow for spending plans;
> - Identification of equipment installations indentifying the regulations met by the equipment installations;
> - Timing of equipment;

[54] See Consumers reply brief at 3-4.

- Rationale for choice of equipment;

- Identification of past equipment installed and for what purpose.[55]

In its reply brief, Staff again asserts that the requests remain completely unsupported by the Company in this case, that its filing contains minimal information and does not present a strategy for how it spends money for environmental compliance.[56]

In its reply brief, MEC/NRDC argues:

> As Staff witness Rusnak detailed, Consumers never submitted its Big Five capital spending plan for a full and meaningful review by the Commission, Staff, or intervenors; resisted numerous attempts by Staff and NRDC and MeC to obtain information about that plan through discovery; and provided what little information about the plan that is in the record only two weeks before the hearing. Consumers' intransigence should not be rewarded by allowing recovery on this record for a major phase of the company's effort to spend approximately $1.8 billion of ratepayer money on the Big Five units over the next six years.[57]

And discussing Ms. Popa's rebuttal testimony, MEC/NRDC argues:

> Nowhere in the record did Consumers provide support for the controls that were selected, the estimated prices of those controls, whether additional units should be mothballed or retired rather than retrofitted with controls, or whether it is financially advisable for Consumers to install well over a billion dollars of pollution controls on coal units that were built between 32 and 53 years ago. Such information, presented in a manner that allows for expert review and discovery by the Commission, Staff, and intervenors, must be provided before any finding that the proposed expenditures are part of just and reasonable rates could be made.

* * * *

[55] See Consumers reply brief, page 4, citing 6 Tr 1319, 1325-1326, 1439-1450, and Exhibits A-53 through A-59.
[56] See Staff's reply brief, 18-21.
[57] See MEC/NRDC reply brief, page 2.

> Consumers indirectly rejects the retirement option for the Big Five units by contending that its generation assets "provide great value to customers." But Consumers fails to point to any evidence showing that each of the Big Five will continue to "provide great value to customers" after the significant cost of capital expenditures is factored in, or that these units will provide greater value than other approaches to serving customer needs that would avoid the major expenditures at issue in this proceeding. . . Instead, the two pages of testimony cited by Consumers simply offers a series of unsupported statements about the benefits of the environmental expenditures the company is proposing, and mistaken claims that such expenditures are "not discretionary."[58]

This PFD recommends that the Commission adopt Staff's recommended adjustments to the environmental capital expense projections, excluding projected 2012 expenditures until the company provides greater detail and support for the timing and amount of its proposed expenditures. As Staff and MEC/NRDC point out, in its November 4 order in Case No. U-16191 the Commission did provide direction to the company regarding supporting its capital expenditures:

> Consumers shall file in subsequent rate cases stronger evidence that will demonstrate its commitment to major capital projects and O&M expenses. For example, Consumers could file proposals and plans that have been provided to upper management or the Board of Directors for approval, actual and projected spending levels and completion status for the three years before and after the test year respectively, and any other evidence that will demonstrate Consumers' commitment to its projected major capital projects and O&M expense.[59]

Previously, in its November 2, 2009 order in Case No. U-15645, the Commission also articulated its expectations as follows:

> For future guidance, the Commission's expectation is that the parties will fully document the basis for their test year projections by offering into evidence detailed supporting explanations and underlying assumptions rooted in expected business, financial, and economic circumstances. Rate applications may not rely on undocumented estimates of future ratemaking expenses and revenue criteria. When necessary, parties

[58] See MEC/NRDC reply brief, pages 3-5.
[59] November 4 order, Case No. U-16191, page 8.

> should provide competing projections, with a similar basis of support. The record thus created should lend itself to a comparative review of the reasonableness and prudence of the projections. Historical data may play a role, but ordinarily will not be the controlling factor except in circumstances that clearly demonstrate that it is a more fair and reasonable reflection of the utility's cost of service, relative to projected data.[60]

In a subsequent order in that case, addressing requests for rehearing and clarification, the Commission quoted its January 11, 2010 order in a Detroit Edison rate case, Case No. U-15768 et al., as follows:

> [T]he Staff and intervenors should direct their focus "upon the strengths and weaknesses of the evidentiary presentations of the parties regarding specific expense and revenue projections." . . . In a case where a utility decides to base its filing on a fully projected test year, the utility bears the burden to substantiate its projections. Given the time constraints under Act 286, all evidence (or sources of evidence) in support of the company's projections should be included in the company's initial filing. If the Staff or intervenors find insufficient support for some of the utility's projections they may endeavor to validate the company's projection through discovery and audit requests. If the utility cannot or will not provide sufficient support for a particular revenue or expense item (particularly for an item that substantially deviates from the historical data) the Staff, intervenors, or the Commission may choose an alternative method for the projection.[61]

Consistent with Staff's and MEC/NRDC's analysis, the company was expected to present the support for its proposed environmental capital expenditures in its direct case. While Staff and the intervenors may endeavor to validate the company's projection through discovery and audit, the burden is on the company to provide adequate support for its projections. In this case, no supporting cost detail was provided for over $.5 billion in proposed capital expenses for 2011 and the first 9 months of

[60] See November 2, 2009 order, Case No. U-15645, page 9.
[61] See January 25, 2010 order, Case No. U-15645, page 10.

2012.[62] The short hand reference to “fabric filters” and “activated carbon injection” in Mr. Kehoe’s testimony, and to “PM 2.5” and “Mercury” in his Exhibit A-29 is not cost detail, when those designations refer to expenditures of over $100 million. Virtually the entire detail for these expenditures included in the company’s direct case is found in Mr. Kehoe’s testimony as quoted above.

The company acknowledges that environmental regulations can take years of lead time for designing, permitting, engineering, procuring, and constructing.[63] Yet, no breakdown of expenses to reflect these stages of the project or the different cost components was provided in Mr. Kehoe’s testimony.

Staff and MEC/NRDC also are correct that the company did not provide responsive answers to discovery. As Ms. Rusnak testified, the company did not provide the information sought by Staff. For example, a review of Exhibit S-13 shows that the company was asked in ST-CE-12 to provide “by plant and unit and by year what Consumers Energy has done to date and/or is planning to do, as well as associated costs to comply with” listed environmental obligations, including National Ambient Air Quality Standards, PM 2.5 and the Clean Air Transport Rule (CATR) identified in Mr. Kehoe’s exhibits, and the Michigan Mercury Rule. Instead, Mr. Kehoe’s response referred only to the spreadsheet provided in response to Staff discovery question ST-CE-11, also included in Exhibit S-13, which does not contain that detailed information. Staff discovery question ST-CE-13, included in NRD-13, asked for “the actual or anticipated costs by plant and unit associated with parts a through l referenced in

[62] On lines 13 and 14 of Exhibit A-29 alone, the company is proposing to spend over $100 million in 2011 and over $250 million in the first nine months of 2012.
[63] See Consumers reply brief, pages 3-4.

question 2 above."[64] The attached spreadsheet shows only line items of spending for 2011 and the first nine months of 2012. Staff followed up with an audit request in Exhibit S-14:

> 2. Referring to Discovery response 16794-ST-CE-13, the question may have been unclear to the Company as to what Staff was asking. The goal of the question is to get a sense of what Consumers has spent to date (actual costs) to comply with any of the environmental rules identified in the question (a. through i.), going back as far as needed. Please provide the actual costs by plant, unit and year, associated with parts a. through i. referred to in Question 16794-ST-CE-12.

The answer refers to a spreadsheet, included in Exhibit S-14, that contains costs only for the projects, identified in eleven lines, for which the company is seeking cost recovery in this case, and does not provide the historical cost information Staff was seeking regarding the company's overall environmental compliance expenditures.

Other discovery responses provided by the company are notably nonresponsive. For example, in Exhibit S-12, the question and response to ST-CE-19 are as follows:

> Question:
>
> 19. Please describe how the pollution control equipment installed to date and through 2012 fits into an overall compliance strategy.
>
> Answer:
>
> 19. The pollution control equipment installed to date, and through 2012, was intended to comply with both State and Federal regulations that pertain to emissions of electric generating power plants. Furthermore, because these regulations continue to evolve, so will Consumer's overall compliance strategy.

In Exhibit NRD-60, the company was asked to follow up on its response to ST-CE-13 (Exhibit NRD-13) in which it identified PM 2.5 and NAAQS as the basis for line items of cost:

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[64] From context, it appears the reference to "2" was intended to be "12".

4. Refer to discovery response 16794-ST-CE-13:

a. For each unit listed, provide the break-out of dollars projected for compliance with the annual standard for PM 2.5 and the dollars projected for compliance with the 24-hour standard for PM 2.5.

b. If the dollars cannot be broken out between the two regulations, is the reason because the same emissions abatement equipment will meet both regulations?

c. If the answer to the previous sub-part is yes, describe in detail the basis for the company's determination that the same emissions abatement system will meet both regulations, and produce any and all supporting documents.

Answer:

4.

a. Our compliance program is not based on the National Ambient Air Quality Standards (NAAQS) for PM 2.5 or any other pollutant. Our compliance program is based on regulations put in place by the US EPA or the Michigan Department of Environmental Quality in order to meet the NAAQS. These regulations include CSAPR.

b. Please see response to a.

c. Please see response to a.

As noted above, the company relies on the material presented in Exhibits A-53 through A-59 to establish that Staff was provided with sufficient information to justify the expenditures. A review of these exhibits shows that they do not contain the detailed information Ms. Rusnak's testimony shows that Staff requested.

Exhibit A-53 is the company's response to ST-CE-11, dated August 5, 2011, filling in a spreadsheet supplied by Staff.[65] The spreadsheet identifies 10 projects, with two pages for each project. It identifies a total cost for each project. Asked for installation dates, the spreadsheet states "spending in plan case period" for each

[65] Exhibit A-53 is also Exhibit NRD-8, and is part of Exhibit S-13.

project. For in-service dates, the spreadsheet contains vague date references, such as "2014 or later." It does not comprehensively detail past or projected future spending by project, unit or plant.

Exhibit A-54 is discovery response NRDC-CE-67, dated August 11, 2011, which asked the company to identify for each generating unit the capital investments it anticipates may or will be needed to comply with various environmental regulations. For the Michigan Mercury Rule, the company's response is only: "CE *anticipates* the installation of fabric filter coupled with activated carbon injection for compliance with the Michigan Mercury regulation."[66] For the Clean Air Interstate Rule, the company's response is only: "Scrubber and/or SCRs have or will be installed *as needed* for compliance with CAIR and/or its replacement, CSAPR."[67] For the Cross State Air Pollution Rule (which was finalized on July 6, 2011 and subsequently vacated), the EGU MACT discussed by Mr. Kehoe in his testimony, and for several other regulations, the company responded that it is still evaluating the regulation or is unable to determine the necessary capital expenditures required for compliance.

Exhibit A-55 is discovery response NRDC-CE-80, dated August 30, 2011, which asked for copies of assessment, analyses, and studies of the need to install, or the economics of installing, additional pollution controls at any of the company's coal-fired generating units. The company responded that a "significant number of 'assessments, analyses and studies" . . . *might* be responsive to this question," but asserted the studies were confidential and would not be provided without an acceptable confidentiality agreement. The response also indicates that the company forecasts

[66] Emphasis added.
[67] Emphasis added.

future NOx and SO2 emissions using a production cost model, and assessed the need to install various equipment using that model.

Regarding EGU MACT, the response also indicated the following:

> Consumers Energy anticipates the installation of flue gas desulfurization equipment (spray dry absorbers and/or dry sorbent injection) for acid gas removal coupled with a pulse jet fabric filter to address the additional particulate loading for compliance with the EGU MACT.
>
> Additionally, Consumers Energy is currently evaluating the feasibility of dry sorbent injection as an alternative means to reduce SO2 and other acid gases. This analysis is in a preliminary stage. Consumers Energy also anticipates that the installation of scrubbers will be necessary meet the SO2 caps required for compliance with CSAPR at some of its electric generating units.
>
> We also anticipate fabric filters coupled with activated carbon injection for compliance with the EGU MACT non mercury metals HAPS and the mercury HAPS standard. Discussion of the assessment and need to install this equipment for mercury control is included in our response to question 79.

Exhibit A-56 is NRDC-CE 259, dated October 11, 2011, which first asks the company to "detail Consumers' overall compliance strategy". The response indicates:

> Consumers Energy's overall environmental compliance strategy is based on meeting current and anticipated state and federal environmental regulations. As stated in [Exhibit A-55], Consumers anticipates that flue gas desulfurization, selective catalytic reduction, fabric filters, and activated carbon injection *may* be required to meet its regulatory obligations. *However, those obligations remain fluid as environmental rules and regulations are proposed, promulgated, reconsidered and or litigated.* To date, Consumers energy has installed SCRs on three units, fabric filters on two units, and is working on the engineering for two more fabric filters and two spray dry absorbers.[68]

The second and third parts of the discovery request ask for an identification of all documents in which the company's overall compliance strategy is memorialized, and

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[68] Emphasis added.

copies of those documents. The company's response is to refer only to 16794-ST-CE-11, which is Exhibit A-53 and part of Exhibit S-13 discussed above. In fact, the response to parts b and c of Exhibit A-56 states: "The spreadsheets previously provided in 16794-ST-CE-11[69] show the compliance strategy for all controls installed or under construction through the test case plan period." As Ms. Rusnak testified, the spreadsheets do not provide any information regarding controls installed prior to 2011.

Exhibit A-57 is discovery response AG-CE-121, dated October 4, 2011. It asks, for each of the environmental projects shown in Exhibit A-29, for the time frame with start and end date, the total project cost, and the amount to be spent each year; the date when compliance with the rules must be achieved; any analysis the company has performed to determine that these expenditures are justified versus other alternatives available to the company; and any analysis the company has performed to assess whether it would be more advantageous to retire generating units. The response indicates in part:

> For air quality regulations, the stringency of the regulations requires significant reductions which can only be achieved with selective catalytic reduction for NOx, flue gas desulfurization for SO_2 and fabric filters and activated carbon injection for mercury. Our approach was to first control the largest units to exploit the "economy of scale" principle. Secondly, some regulations (Michigan Mercury Rule and proposed EGU MACT) require controls on every unit. The attached studies support these expenditures.

The only study attached is dated September, 2008: it does not directly support the proposed expenditures by unit, or identify the specific unit-by-unit controls or alternatives to comply with the Michigan Mercury Rule or EGU MACT. Finally, the discovery response references an additional study, but indicates it is confidential.

[69] See Exhibits S-13 and A-53.

Exhibit A-58 appears to be a power point presentation, dated September 24, 2010. It also lacks meaningful cost information. On pages 6 and 16, there is a bar graph titled “spending plan”, with time periods identified for the installation of “fabric filters”, “activated carbon”, “Spray Dry Absorbers”, and “SCR” for the Campbell units 1 through 3 and Karn units 1 and 2. Page 20 has a chart showing “base case” and “high cost case” rate increases over the period 2010 to 2018, at no level of detail greater than Exhibit A-29.

Exhibit A-59 is a spreadsheet which is essentially the same spreadsheet provided in Exhibit S-14. It shows only actual spending over the period 2006-2010, “target” spending for 2011, and budgeted spending over the period 2012 to 2020 broken down by 17 projects[70] associated with the Clean Air Act and Michigan Mercury Rule: the installation of fabric filters at all five plants, two of which are shown as just completed, the installation of SDA at three plants (Karn units 1 and 2 and Campbell unit 3), and the installation of SCR and ACI at Campbell unit 2.

Additionally, the information provided by the company in its discovery responses is confusing, and contradicts the information presented by Mr. Kehoe in key respects. One of Staff’s major concerns was that the company did not provide information on past environmental capital expenditures, only information on projects for which the company was proposing to make capital expenditures during the projected test year.[71] Mr. Kehoe testified that in the time period 2010 to 2012, fabric filters will be installed on Campbell

[70] Ten projects match the spreadsheets in Exhibits S-13 and A-53; one project is labeled “JHC COMM SDA”; the spreadsheet also identifies 6 projects dealing with RCRA and the Clean Water Act.
[71] See Exhibits S-13 and S-14.

units 1 through 3, along with ACI discussed below.[72] The information provided in Exhibit A-53 (and Exhibit S-13), and Exhibit A-59 (and Exhibit S-14) shows fabric filters will not be completed on those units until 2013 or later for unit 2, 2014 or later for unit 1, and 2015 or later for unit 3. Ms. Popa's testimony, and Exhibit A-56 indicate only that the company is working on the engineering for two fabric filters.[73]

Regarding Mr. Kehoe's testimony that activated carbon injection (ACI) was installed or will be installed by the company at the Karn units 1 and 2 between 2009 and 2011, and for the Campbell units 1 – 3 between 2010 and 2012,[74] Exhibits S-14 and A-59 do not show any planned expenditures in 2011 for ACI, and only show planned expenditures in 2012 for ACI for Campbell unit 2. Moreover, the bar graphs on pages 6 and 16 of Exhibit A-58 do not show the company planning to install ACI on the Karn units and other Campbell units (units 1 and 2) until at least 2013.

Additionally, Mr. Kehoe testified that the company had already invested in Selective Catalytic Reduction (SCR) for Campbell unit 2, and would be investing in SCR and SDA for Campbell units 1 through 3 and Karn units 1 and 2 during the time period 2010-2012. While the spreadsheet in Exhibits S-14 and A-59 show spending in the projected test year on spray dry absorbers (SDA) for Karn units 1 and 2 and Campbell unit 3, SCR is included only for Campbell unit 2. Ms. Popa testified that SCRs had already been installed on three units, Karn unit 1 (2003), Karn unit 2 (2004) and Campbell unit 3 (2007), citing Exhibit A-56.[75]

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[72] See 6 Tr 1325.
[73] See 6 Tr 1444, Exhibit A-56 ("To date, Consumers Energy has installed . . . fabric filters on two units, and is working on the engineering for two more fabric filters and two spray dry absorbers.")
[74] See 6 Tr 1325, lines 5-7.
[75] See 6 Tr 1444.

For the SDAs, Mr. Kehoe's testimony as noted above indicates that SDAs will be installed on all five units. The information in Exhibits A-53 and S-13 and Exhibits S-14 and A-59, however, shows that SDA is planned for only three units, with expenditures included in the company's rate case projections, and installation dates 2014 through 2016 "or later". Likewise, the bar graphs on pages 6 and 16 of Exhibit A-58 show spending on SDAs for Campbell units 1 and 2 starting in 2013 and 2014.

Looking at the company's response in Exhibit A-53 and Exhibit S-13, the information filled out for the fabric filters for each unit indicates that: "ACI/SDA *may* be needed . . .",[76] yet without explaining how it came to the decision ACI and SDA are needed, the company is proposing to install ACI on one unit and SDA on three units. Also, the company's response in part c of Exhibit A-55 indicates as follows regarding the SDAs:

> Consumers Energy anticipates the installation of flue gas desulfurization equipment (spray dry absorbers and/or dry sorbent injection) for acid gas removal coupled with a pulse jet fabric filter to address the additional particulate loading for compliance with the EGU MACT.
>
> Additionally, Consumer Energy is currently evaluating the feasibility of dry sorbent injection as an alternative means to reduce SO2 and other acid gases. This analysis is in a preliminary stage.

And, looking further at the spreadsheet provided in Exhibit S-14 and Exhibit A-59, the costs proposed for 2011 and 2012 do not add up to the total requested in Exhibit A-29. Instead, the Exhibit S-14 spreadsheet shows capital expenditures for Clean Air Act and Michigan Mercury Rule compliance totaling \$114.7 million in 2011 and \$251.4 million in 2012, a total of approximately \$366 million. Exhibit A-29, lines 13 and 14, shows capital expenditures of \$111.8 million for 2011 for PM 2.5 and mercury control,

[76] Emphasis added.

and $284.3 million for 2012, a total of approximately $396.1 million. This is a difference of approximately $30 million.

The confusion in these responses regarding what has already been installed, what will be installed in the future, and what amounts are to be spent from the historical to the projected test year shows that Staff's interest in the company's historical capital expenditures on environmental compliance is not merely academic.

Based on a review of the record, this PFD concludes that the company did not provide in its initial filing the information described by the Commission in its November 4 order, and did not provide this information in response to Staff discovery and audit requests or in response to discovery from other parties. In addition, this PFD concludes that the company has failed to establish that it undertook a reasonable and prudent analysis of the appropriate amount and timing of its environmental compliance costs. For these reasons, this PFD recommends that the Commission adopt Staff's recommended adjustments to the company's projected capital expenditures for environmental compliance. As Ms. Rusnak testified and as Staff argues in its brief, this adjustment does not foreclose the company from making these capital expenditures or from providing additional support for these expenditures in its next rate case.

b. <u>“Marginal plants” or “seven classics”</u>

In its initial brief, Consumes Energy emphasizes Mr. Kehoe's rebuttal testimony, indicating that the company's proposed capital and O&M expenses are not affected by its plan to mothball the seven classics starting in 2015.

MEC/NRDC's brief notes that the company's announcement to mothball the plants was made two weeks before the start of the evidentiary hearings in this matter, and notes that the company's planned capital expenditures for these plants of $19.1 million during the test year. MEC/NRDC argues that the proposed spending was problematic at the time the company filed its case, and further argues not only that the company did not present evidence that these capital expenditures are still necessary, but has not even evaluated the issue.[77] MEC/NRDC cites in particular a portion of Mr. Kehoe's cross-examination, indicating that from the time it made the decision to mothball the units, no analysis was performed whether any of the planned expenses could be avoided.[78] MEC/NRDC also addresses Mr. Kehoe's rebuttal testimony indicating a "small but significant benefit to customers" from continued operation of the unit. MEC/NRDC notes that no such study was ever presented on the record, and cites the company's discovery response in Exhibit NRD-64, which did not identify or produce any documented study.[79]

MEC/NRDC also argues that the company has not shown it is necessary for the company to operate all seven of the units until 2015, asserting that even if the company has a study showing a net benefit from operating all seven units, it has not established a benefit from operating each and every one of the seven units. In this context, MEC argues that the Whiting units are responsible for over half of the proposed capital

[77] See MEC/NRDC brief, pages 6-17.
[78] See 6 Tr 1381-1382.
[79] See MEC/NRDC brief, pages 14-15, and n64.

expenditures for the test year, but are the least efficient of the seven classics measured by heat rate and the most expensive of the seven to dispatch.[80]

MEC/NRDC also reviews Staff's testimony regarding five of the seven plants, and argues that Staff's recommendations should be extended to the Weadock units 7 and 8 as well, for which MEC/NRDC argues proposed capital expenditures for the first nine months of 2012 total $2,285,000.

Staff argues that the company's decision to mothball the plants further supports its argument that the company should not be allowed recovery of additional expenditures for these plants. In its reply brief, Staff recommends that capital expenditures for the Weadock units 7 and 8 should also be removed form the test year projections, and concurs with MEC/NRDC that the amount of the additional adjustment is $2,285,000.[81]

This PFD recommends that the Commission adopt Staff's and MEC/NRDC's recommendation to remove the company's projected test year capital expenditures for the seven classics from the net plant calculations. Mr. Kehoe's rebuttal testimony regarding these expenses asserts that the expenses are necessary to safely operate the plants through 2014, and that "Consumers Energy is not seeking recovery of costs that contemplate operation beyond that date."[82] This does not establish that the projected expenses were evaluated and determined to be the appropriate expenses for plants that would be mothballed by January 1, 2015. While Mr. Kehoe testified to a "small but significant benefit to our customers in the continued operation of these units

[80] MEC/NRDC cites Exhibit NRD-18.
[81] See Staff reply brief, page 18.
[82] "Costs"

until 2015", he did not present any analysis to establish this benefit. As MEC/NRDC argues, there is no specific justification on this record for the selection of 2015 as the mothball date for each of these units. Perhaps it would be prudent for the company to stagger the mothballing of the plants, and reduce its capital expenditures.

To give the Commission the opportunity to review the reasonableness and prudence of its decision making, the company could have sought to amend its filing to present evidence and analysis supporting its December 2, 2011 decision to mothball these plants, and the appropriate cost projections. It chose not to do so. Likewise, while it seeks to rely on Mr. Kehoe's testimony asserting a "small but significant benefit" from continued operation of the plant, the company chose not to present any such study in response to MEC/NRDC discovery.

As with the environmental capital expense projections discussed above, this recommendation does not foreclose the company from recovering these expenses in the future. In its reply brief, Consumers urges the Commission to approve expenses to allow for the economic, orderly mothballing of the plants. Consumers Energy should be given the opportunity to demonstrate that it has planned the appropriate expenditures to do just that. In the meantime, ratepayers should not be asked to front potentially imprudent costs.

c. <u>Attorney General's proposed adjustments</u>

Relying on Mr. Coppola's testimony discussed above, the Attorney General asks the Commission to reject a total of $183 million of the company's projected capital expenditures.[83] The Attorney General argues that Consumers Energy has not met its burden of proof to establish that the expenditures are reasonable and prudent. The company in response relies on Mr. Kehoe's rebuttal testimony, and argues that the Attorney General's recommendations are not supported.

Turning first to Mr. Coppola's recommendation that the Commission reject projected and past expenditures for Ludington on the basis that it is underutilized, as the company argues, Mr. Coppola's testimony does not address the nature of the Ludington plant. The Ludington project is an ongoing one, and Mr. Coppola's recommendations extend to past capital investments in the plant, without a record to establish that those previous investments were unreasonable or imprudent, or were not invested in used and useful utility plant. Mr. Kehoe explained the Ludington utilization clearly in his rebuttal testimony. The Attorney General does not address this rebuttal testimony in his briefs. For these reasons, this PFD recommends that the Commission reject the Attorney General's proposed adjustment to net plant for Ludington capital improvements.

As to the Karn units 3 and 4 and combustion turbines, Mr. Coppola's recommendation to reject $6.3 million in proposed spending is not clearly tied to the company's projected expenditures on these units.[84] The company's Exhibit A-29, line 5, shows total spending of $.9 million in 2011, and $3.4 million for the first nine months of 2012. Although Mr. Kehoe did not present any testimony directly addressing lines 5 and 6 of Exhibit A-29, he did testify regarding the major maintenance expenses (O&M) for the Karn units 3 and 4. He testified that unit 3 will receive a turbine inspection, and unit

[83] See Attorney General initial brief, pages 43-52.
[84] See Kehoe, 6 Tr 1349.

4 will have repairs made to the boiler, cooling towers and breaker; high energy piping system and flow accelerated corrosion (HEPS and FAC) testing will also be performed. His Exhibit A-26 did indicate an approximately 1-month outage for Karn unit 3 in 2012. He also discussed non-outage maintenance work at Karn generally.[85] Because the work to be done appears to be routine, because the units have not been identified as likely to be retired, and because it is not clear from his testimony what expenditures Mr. Coppola was evaluating, this PFD recommends no additional adjustment to the company's net plant projection for the Karn units 3 and 4 and combustion turbines.

Regarding the Attorney General's proposed recommendation to disallow 20% of the proposed remaining generation capital expenditures, Consumers argues that such an adjustment is arbitrary and inappropriate, citing Mr. Kehoe's rebuttal testimony. Again, the Attorney General's briefs have not addressed the company's rebuttal testimony, or the Staff and MEC/NRDC analysis of the company's proposed capital expenditures, discussed above. For these reasons, this PFD recommends that the Commission reject the Attorney General's proposed 20% adjustment to the company's fossil/hydro generation capital expense projections for 2011 and 2012.

2. Electric Distribution System

For electric distribution system capital expenditures, Consumers forecast expenditures of $318 million for 2011 and $244 million for the first nine months of 2012, as shown on Mr. Anderson's Exhibit A-13. His presentation categorized the proposed expenditures into seven programs: "new business", "reliability", "capacity", "demand

[85] See 6 Tr 13131314.

failures", "asset relocations", "technology/production support" and "electric business services." Regarding the proposed reliability expenditures, he testified to a direct and measurable relationship between the level of investment made and the reliability and quality of service experienced by customers. He testified that the company's capital and O&M expense requests are projected to improve electric distribution reliability and meet the Commission's service quality and reliability standards. He also testified to the company's reliance on the Decision Analysis Reliability Evaluation or "DARE" model to predict system performance, and reviewed performance standards including the System Average Interruption Duration Index (SAIDI), System Frequency Index (SAFI), and Customer Average Interruption Duration Index (CAIDI), as well as the Repetitive Outage and Normal Conditions Restoration performance standards adopted by the Commission.

Reviewing the projected capital expenses for each category, he explained that the reliability capital expenditures include investments to install, upgrade and rehabilitate LVD lines, metropolitan underground systems, the SCADA system, protective relays, HVD lines, and substations. He testified that the company is projected total capital expenditures in this category to be $89.7 million in 2011 and $76.6 million in the first nine months of 2012, as shown on line 2 of Exhibit A-13, and these amounts include funding for line equipment rehabilitation and an expanded pole replacement program, and funding to address repetitive outages. He further testified that the capital expenses are all directed at preventing outages and/or replacing obsolete equipment. He described in greater detail work on the company's LVD and HVD lines, and substations, and testified that these capital expenditures along with the company's proposed O&M expenditures address the three leading causes of customer outages on the company's system, which he identified as trees, equipment failures, and lightning/weather.

Regarding the business service category, he testified that this category includes facilities repair and upgrades, transportation fleet investments such as vehicles and trailers, and some computer equipment. He testified that the company is projecting expenses in this category of $20 million for 2011 and $16.9 million for the first nine months of 2012, as shown on line 7 of Exhibit A-13.

Mr. Anderson's testimony discussed the impacts of the planned expenditures on reliability, using the DARE model to predict the likely range of SAIDI values from 2011 through 2020. He testified that without the projected levels of spending, the company's modeling predicts that reliability will deteriorate and the company's ability to meet performance standards will suffer. He noted that the company has increased its spending since 2006, and with the exception of 2008, has seen an improvement in electric distribution system performance. He testified that the improvements are a direct result of the additional spending.

Referencing his Exhibit AG-16, Mr. Coppola testified that the company's proposed capital expenditures for 2011 and the nine months ending September 2012, total $562.7 million for the electric distribution system, with $166.4 million relating to service reliability improvements, and $36.8 million relating to business support services.[86] Regarding proposed reliability improvements, he testified that the company's proposed spending amounts to an increase of 40% above 2010 levels, and

[86]See Coppola, 4 Tr 704-706.

double the spending in 2008. He also testified that in Case No. U-16191, the company proposed to spend $131 million in 2010, but did not attain that level in 2010 and likely would not in 2011 either, although the company's forecast spending level was included in rates. Mr. Coppola testified that a more realistic and reasonable level for the nine months of 2012 would match the level of expenditure in 2011, resulting in a forecast of $67.3 million, or a reduction of $9.3 million in the company's forecast.

Looking at the business support service projections, Mr. Coppola testified that the company had not explained the large increases it projected over 2010 levels (30% to 43% for 2011 and 2012), and recommended that the Commission also use the 2011 spending levels to project 2012 expenditures, resulting in a projected capital expenditure for the first nine months of 2012 of $14.9 million, or $2 million less than the company's projection.

Mr. Sansoucy also testified regarding the company's planned electric distribution system expenditures.[87] He presented Exhibit NRD-30 to show the company's total planned capital spending, and asserted that the company is proposing to spend $2.0 billion in electric distribution capital expenditures and $1.5 billion in O&M over the next six years on its distribution. In addition to the proposed capital expenditures, he testified that the company deducts approximately $152 million per year in depreciation expense on its distribution system, which it recovers through base rates, or approximately $900 million over the six-year period. Expressing his concerns with the level of line losses on the company's system, he testified that the company is not proposing to spend any of this money to reduce its line losses. Arguing that the ratepayers would benefit from a

[87] See 6 Tr 1497-1500; Exhibits NRD-22 to NRD-35.

reduction in line losses from the 2010 level of 9.1% to the 2007 level of 7.2%, which he equates to 700 million kWh, 402,500 tons of coal, and $18,786,600 in coal costs, he recommended that the Commission deny recovery of the capital and O&M expenses for the distribution system until the company designs, submits and implements a plan to reverse the worsening trend in its line losses.[88]

Mr. Reasoner testified on behalf of Staff regarding the company's proposed reliability expenditures. [89] He reviewed the historical reliability capital expenditures presented in Exhibit A-13, and discovery responses, and summarized them in chart form in his testimony. He testified that Staff does not support the company's proposed expenditures because the company has not established that distribution reliability in its service territory is improving in direct proportion to the recently increased funding level for capital expenditures:

> Consumers have spent considerable [sic] more money in the last few years than their 5 year average of $46.6 million. Consumers have spent $63.5 million in 2009, $71.2 million in 2010, and $89.7 million in 2011. Additionally, Mr. Anderson did not present any specific evidence or cost benefit analysis that shows that a further increase in funding level for reliability expenditures would result in a very specific increase of distribution reliability based on the current conditions of the Company's infrastructure.
>
> Staff does not find evidence that the most recent 2011 increase in funding for capital expenditures provides a significant increase in distribution reliability and therefore, does not believe an increase is justified until recently increased spending levels provide evidence of improvement.[90]

Mr. Reasoner testified to his review of the company's performance using various performance standards, including the System Average Interruption Duration Index

[88] The calculations showing customer benefits are presented in Exhibit NRD-35.
[89] See 5 Tr 1143-1153.
[90] See 5 Tr 1145.

(SAIDI), System Frequency Index (SAFI), Customer Average Interruption Duration Index (CAIDI), with and without "major event days" included. He presented Exhibit S-16 to show Institution of Electrical and Electronics Engineers (IEEE) benchmarks for the time period 2006 to 2009, reflecting performance statistics for 190 utilities. He testified that Consumers performed in the 4th quartile as measured by the SAIDI standard and the CAIDI standard, and in the second quartile as measured by the SAIFI standard looking at the time period 2006 to 2009. He testified that the company improved its performance by each of these measures in 2010, but not enough to change its quartile ranking.

Mr. Reasoner also looked at the company's performance under service quality performance measures adopted in Case No. U-12270 (January 29, 2004 order). Using these measures, he testified that the company has generally met the service quality standards related to distribution reliability.

Based on this review, Mr. Reasoner explained Staff's recommendation that the Commission approve expenditures for the first nine months of 2012 that are equivalent to the level of monthly expenditures approved for 2011 in the November 4 order in the company's last rate case, U-16191. He testified that the company received an increase in its capital spending level of 52% over historical averages in that case, and those levels should be considered adequate until the company can demonstrate that its reliability will improve with the additional funding: "Staff maintains that the amount of reliability capital expenses included in rates should represent reasonable levels tied closely to Consumers' historic spending patterns until the company can demonstrate a direct correlation to improved system reliability."[91]

In his rebuttal testimony, Mr. Anderson testified regarding Staff's and the Attorney General's recommended adjustments to the reliability capital spending forecast for 2012. While he recognized that the proposals represent a significant improvement over historical spending patterns, he explained that the company's proposed spending levels include additional costs for deteriorated pole replacements that are identified as a result of a more rigorous pole inspection program ramping up in 2011 and 2012, as well as increased line rehabilitation. He testified that these efforts would cost-effectively improve system reliability. He pointed to his direct testimony reviewing improvements in the company's performance measures, and testified that such improvements would not necessarily be in direct proportion to increases in funding: "Although localized capital expenditures are highly effective at addressing poor performing portions of the system, overall system reliability metrics are also impacted by the size, age, condition and performance of the portions of the electric distribution system that the Company has not worked on or improved in a given year."[92] He further testified that equipment failures are the second biggest cause of outage on the company's distribution system, responsible for 19% of the company's outages, and that the company's proposed level of spending would only permit working on 1.9% of the distribution system. He presented his responses to discovery in Exhibit A-50.

Specifically addressing Mr. Coppola's recommendation on electric reliability capital expenses, which parallel's Staff's recommendation, he testified that Mr.

[91] See 5 Tr 1153.
[92] See 4 Tr 880.

Coppola's recommendation was not based on what is actually needed to make significant improvements over time, but rather is based on recent spending.[93] He testified that Mr. Coppola's logic ignores the fact that historical expenditures have not allowed the company to keep up with the normal deterioration of a large base of assets in the field.

He also addressed Mr. Sansoucy's testimony recommending improvements in line losses as a condition of spending increases.[94] He explained that line loss or "total energy loss" includes all unaccounted for energy including such things as transformer and power line losses due to current flow, fixed core losses associated with energized transformers, unmetered station power, and theft of power on the company's system, as well as similar unaccounted for energy on the transmission system owned by the Michigan Electric Transmission Company. He testified that many variables affect line loss, and that line loss is not the primary driver for capital expenditures. While he testified that energy losses cannot be totally eliminated and are not totally consistent, he indicated that the company does consider the effect on line losses of various alternatives in its decision-making process.

He further noted that Mr. Sansoucy had not explained how the company could reduce line losses to their 2007 level, or what the cost would be. In his opinion, it would take a significant investment above what the company is requesting in this case to reduce line loss, including converting the company's low voltage distribution system to higher voltage, or replacing the No. 4 ACSR conductor with 1/0 ACSR conductor. Mr. Anderson testified that in Case No. U-16191, he had estimated the cost of each of these

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[93] See 4 Tr 887.
[94] See 4 Tr 889-894

improvements to be over $4 billion each. His Exhibit A-51 presents his analysis of the cost to reduce line loss by 700 million kWh, concluding it is not economical to do so.

Mr. Anderson's rebuttal also addressed Mr. Coppola's proposed reduction to the business service program capital expense projections.[95] He testified that his direct testimony contained support for the expenditures, citing 4 Tr 867, lines 8 through 23, and also identified information provided as a discovery response showing the historical volatility of expenditures in this category.

In its initial brief regarding the electric distribution capital expenditure forecasts, Consumers relies on Mr. Anderson's rebuttal testimony.[96]

a. <u>Reliability Improvement</u>

Staff's brief relies on Mr. Reasoner's testimony, discussed above, to support its reduction to the company's projected distribution capital spending. Staff also addresses Mr. Anderson's rebuttal testimony, discussed above, arguing that the 52% increase in reliability capital spending awarded in Case No. U-16191 has not yet been shown to provide benefits to customers. [97] Staff argues that the benefits of the previous increase would need to be demonstrated over a longer time period to prudently identify the need for another increase, and a consistent spending level will aid in this analysis. On this basis, Staff contends that maintaining the current level of capital expenditures will allow the company to continue to improve its performance over the next five years.

The company's reply brief further addresses Mr. Reasoner's recommended adjustment to the company's reliability expense projection, contending that the basis for

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[95] See 4 Tr 887-888.
[96] See Consumers initial brief, pages 5-8.
[97] See Staff initial brief, pages 21-23.

Staff's argument is its allegation that the company's reliability performance is unsatisfactory. The company responds that if there is no increase in spending, it is not reasonable to expect performance to improve from current levels. The company emphasizes that the additional funding proposed is for deteriorated pole replacements and increased line work to address repetitive outages, and that elimination of funding for these programs will impede improvements to the company's reliability performance.

In its November 4 decision in Case No. U-16191, the Commission reviewed Staff's deferral proposal in the context of reliability improvements. The Commission found the company's proposed spending for improved reliability to be reasonable and prudent, but also held:

> Although customers are being asked to pay higher and higher rates, at no time have the customer benefits from higher rates been evaluated. The record indicates that there is clearly room for improvement in Consumers' system operations, especially the company's distribution system. The Commission therefore finds that Consumers shall file, in subsequent rate cases, evidence showing improved system performance and how spending on system operations is accruing to the benefit of customers. The Commission also observes that future approval of rate increases may depend on a satisfactory demonstration of such benefits.[98]

In this case, as Staff explains, the company has not demonstrated significant improvement from prior expenditures. In large part, this is because the company has not had the opportunity to reap benefits from the significant increase in expenditures approved in Case No. U-16191, 52% above the company's previous five-year average. Staff's proposal that the Commission require the company to present an evaluation of the effects of the significant increase in spending authorized in the last rate case before authorizing an additional significant increase, appears reasonable, and a cautious

[98] See November 4 order, pages 8-9.

procedure for ensuring that the company is not simply throwing money at the proverbial problem. Consistent with Staff's recommendation, although the DARE model projections made by the company predict improvements at the level of expense predicted by the company, the company also predicted system improvements in conjunction with its requested spending level increase in the last rate case. Note that Exhibit A-50, a discovery response the company provided, discusses the company's DARE modeling and indicates that modeling was performed using 2010 spending capital and O&M spending levels, and a 10% increase in those levels. For these reasons, this PFD recommends that the Commission adopt Staff's adjustment to the company's proposed 2012 capital expenditures on electric distribution.

b. Line losses

In its brief, MEC/NRDC argues that the company's line losses have increased nearly 50% over the past decade, while "Consumers has made little-to-no effort to understand the cause of this increasing inefficiency . . . and has no plans to address the problem."[99] Emphasizing the benefits of improved efficiency in terms of costs savings, as well as public health and air quality, MEC/NRDC argues that even a modest reduction in line losses would be significant for ratepayers. Focusing on the company's proposed distribution system spending, MEC/NRDC cited Mr. Anderson's discovery responses indicating that the company has no plans to reduce its line loss to a specific percentage, and that the company could not identify a study to support its estimated reduction in line losses for the projected test year.[100] Additionally, MEC/NRDC cites Mr. Ronk's discovery response indicating that the company does not have a study showing

[99] See MEC/NRDC brief, pages 45-51.
[100] See Exhibit NRD-46.

a breakdown of the components of line losses to determine whether they are increasing or decreasing.[101] MEC/NRDC argues that the company's proposed distribution system spending would have only an incidental effect on its line losses, while the company should be expected to avoid incurring excessive line losses and thus should be expected to take steps to reduce line losses to a reasonable level. For these reasons, MEC/NRDC recommends that the Commission condition at least some portion of the distribution-system-related expenditures on the company's development and implementation of a plan to reduce line losses.

Specifically responding to the MEC/NRDC arguments, Consumers argues that the Commission addressed this issue in its November 4 order in Case No. U-16191, and urges the Commission to reject it again.[102] The company also argues that Mr. Sansoucy did not identify how line losses should be eliminated or identify the costs, citing 4 Tr 890, and reviews Mr. Anderson's calculations that the expenditure of $10 billion would not completely eliminate line loss.

In Case No. U-16191, the Commission also addressed concerns raised by MEC regarding Consumers' level of line losses. The Commission found that Consumers' distribution system is far more extensive than that of other comparable sized utilities and the laws of physics account for much of the difference in line losses.[103] Although MEC/NRDC identifies significant savings that could be achieved if the company were to reduce its line losses, this PFD concludes that on this record, there are no clear or

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[101] See Exhibit NRD-24.
[102] See Consumers initial brief, pages 121-123.
[103] See November 4 order, page 13.

economically justified measures by which the company can reduce its line losses, and thus no reasonable ratemaking measures the Commission should impose at this time.

c. Electric business services

The Attorney General seeks a reduction in the capital expense projections for this category of approximately $2 million, arguing that the company's projected 30% increase over 2011 levels is unsupported and unreasonable. The company relies on Mr. Anderson's testimony. Also, specifically addressing the Attorney General's recommendation regarding the business services program forecast, the company argues that in its reply brief that the Attorney General's proposed reductions are equivalent to nullifying the statutory right to use a projected test year and should be rejected.[104]

This PFD recommends that the Commission accept the company's projected capital expenditure of $16.9 million for the first nine months of 2012. Mr. Anderson's testimony indicates that the company's proposed capital expenditures cover a multitude of items, including vehicle and trailer purchases, and building roofing and emergency repairs.[105] The projected expense levels vary from year to year, rather than resulting from projected increases as a function of time. Staff's audit and approach to capital expenditures also ensures that only actual expenditures are recognized for the beginning test year plant balance.

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[104] See Consumers reply brief, pages 7-8.
[105] See 4 Tr 867.

3. Energy Supply Department

For the company's electric supply department operations, the company proposed capital expenditures of $627,000 for 2011 and $352,000 for the nine months ended 2012. No party challenged these projections, presented in the testimony of Mr. Ronk and shown in his Exhibit A-36.

4. Business Technology Solutions

For business technology solutions, as shown in Exhibit A-16, the company projected capital expenditures of $45 million in 2011 and $28.7 million for the first nine months of 2012. The projected capital expenditures were broken into the following categories: software application projects, computer infrastructure and asset management, and major computing infrastructure projects. Ms. Roth, adopting the testimony originally filed by Karen Beers, reviewed the company's SAP implementation, scope, and current and expected future benefits, and illustrated this testimony with Exhibit A-17.[106] She testified that one of the software application projects budgeted for the test year is the enhancement and upgrade of the company's SAP system, including a project referred to as "Customer Relations Module 7 or "CRM 7". She testified that this is a significant project that will both improve service to customers and support the AMI project. She characterized the enhanced customer service employee functions accompanying the CRM 7 as "system navigation improvements" that would reduce the time to handle certain customer transactions and improve productivity, and described

[106] Ms Roth's testimony is at 3 Tr 552-571, and also includes a discussion of the company's projected O&M costs for the BTS department. Ms. Roth also presented rebuttal testimony discussed in more detail below.

the AMI-related benefits as allowing the company to trigger remote meter connection and reconnection, view customer interval data, and obtain on demand customer meter reads. She further testified that completion of the CRM 7 module in late 2011 would lead to a reduction in the company's software-related capital expenditures in 2012.

Regarding computer infrastructure and asset management, she testified that the company intends to minimize costs by replacing assets that are at the end of their useful life, to avoid costly repairs and outages. The major computer projects category includes updating the company's mobile radio system (Land Mobile Radio or LMR), and constructing a new technology center. Emphasizing the importance of communications to the company's field operations, she testified that the company's LMR system is a homogeneous system covering 31,000 square miles, supporting 4,000 subscribers and nearly 70 million transmissions annually. In this project, she testified, the company plans to replace electronics up to 15 years old, and extending the life of the existing system by upgrading the electronics to the most cost and spectrally efficient technology available.

Regarding the projected expenditures for a new technology center, Ms. Roth identified concerns with the two existing technology centers, including the physical risks associated with their geographical location, and facility-related risks.[107] She testified that the company performed an assessment of this proposed project in 2010, which involved "evaluating the efficiency, effectiveness, and suitability of its existing two technology centers, conducting a gap analysis against business requirements and best practices, developing a tactical and strategic plan to remedy any material deficiencies,

[107] See 3 Tr 570.

and producing a situational analysis report and recommendations document."[108] She further testified that the specific actions to be taken to remedy the current situation have not been finalized, and that the preliminary recommendation calls for a new primary data center that would be located in an area with fewer geographical risks. She also testified that management approval of the project was expected in 2011.

Mr. Coppola recommended a $33 million reduction in the company's proposed capital expenditures in the Business Technology Solutions category.[109] Regarding the company's proposed CRM 7 Software project, he reviewed the benefit/cost analysis provided by the company in Exhibit AG-21, and concluded that the project is not financially justified, showing a negative net present value of $3.3 million. He also testified that this negative net present value included as a benefit the value of time customers would save, which he characterized as an "unorthodox" approach to benefit/cost analysis. He challenged the company's decision to spend a total of $28 million to improve the SAP system, contending that the benefits Consumers identified for the CRM 7 would seem to be basic capabilities of the three-year old SAP system. And he further took issue with the company's claim that the CRM 7 is necessary in conjunction with the AMI project, when the AMI project has itself not yet been fully justified. He recommended that the Commission disallow the $17.3 million in total capital expenditures forecast for this project that would be assigned to the electric operations, including all expenditures made to date.

He also recommended that the Commission reject $4.1 million in proposed spending to upgrade the company's land mobile radio system. Citing discovery in which

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[108] See 3 Tr 570.
[109] See 4 Tr 712- 716.

the company indicated the timing for this project has been delayed since the rate case filing, Exhibit AG-21, he recommended that the Commission exclude the $4.1 million from the company's projected capital expenditures.

Similarly, he recommended that the Commission reject forecast spending of $11.6 million for a new data center. Referencing discovery from the company's recent gas rate case, Case No. U-16418, he testified that the company's need for extra data center capacity is driven by the Smart Grid/AMI infrastructure. He indicated that the company's benefit/cost analysis provided in a discovery response in this case showed a negative net present value for the project, as well as a higher projected cost. He also testified that in the same response, the company acknowledged that its senior management had not yet approved the project and it was suspended until the first quarter of 2012.

In her rebuttal testimony, Ms. Roth addressed Mr. Coppola's recommendations.[110] Regarding the CRM 7 project, she reviewed the benefits of the program as discussed in her direct testimony, and testified that it was necessary for the company to continue to provide improved service to its customers and to enable the AMI project. Regarding the LMR system, she disagreed with Mr. Coppola's characterization that the program was not a priority for the company, also asserting that her department remains committed to it. She explained that the timing of the capital expenditures for the project had changed since the company filed its rate case, and presented a revised cash flow in her Exhibit A-67, showing capital expenditures of $1.35 million in 2011 and $1.78 million in 2012, for a total net plant increase of $2.69 million.

[110] See 3 Tr 579-585.

Regarding the technology center, she reviewed the problems associated with the existing technology centers as discussed in her direct testimony, and emphasized the importance of the continued reliability of the company's data centers and the integrity of its systems, including the systems that respond to downed wires and gas leaks.

Noting the magnitude of the company's projected increase in rate base in the projected test year in comparison to historical levels, the Attorney General's brief quotes heavily from Mr. Coppola's testimony in recommending total reductions of $33 million to the projected business technology capital expenditures.

In its initial brief, Consumers relies on the direct and rebuttal testimony of Ms. Roth regarding the CMR 7 project, the LMR project, and the new computer center.[111] The company argues that it provided support for these projects in its direct testimony. The company also notes that Staff did not recommend any adjustment to the business technology solutions capital expense projections. Consumers' reply brief summarizes the company' s position on these expenses as follows:

> Reductions to the CMR 7 software project were based on the Attorney General's position the project was not adequately justified. In reality, there was extensive testimony in the record . . . supporting the CMR 7 software project. Reductions to the land mobile radio system were based on the Attorney General's position the project is not a priority for the Company. Record testimony . . . [details] the need for the land mobile radio system and the fact it is a priority for the Company. Elimination of the date center is based on the Attorney General's position that current data centers are adequate. Testimony in the record . . . details the reasons as to why a new data center is needed and why the current data centers are inadequate.[112]

[111] See Consumers initial brief, pages 21-23.
[112] See Consumers reply brief, page 9.

In his reply brief, the Attorney General emphasizes that the company bears the burden to establish that its projections are reasonable.

This PFD recommends that the Commission accept the company's capital expense projections for the CMR 7 module and for the LMR system upgrades as revised in Exhibit A-67 and reflected in Staff's net plant balances. In making this recommendation, it is noted that the Attorney General did not address Ms. Roth's rebuttal testimony in his initial or reply brief.

Regarding the proposed new data center, however, this PFD concludes that it is premature for the Commission to approve the proposed capital projections. The company's testimony acknowledges that there is no finalized plan, and management approval was still pending when the company filed its case.[113] There is no detail provided regarding the planned expenditures of $5 million in 2011 and $6.3 million in 2012. It does appear from Ms. Roth's testimony that a new data center is a reasonable idea, but the record does not support the appropriate amount or timing of spending on that data center, and does not meet the criteria identified in Case No. U-16191. Given the frequency with which the company has been filing rate cases, it would be more sensible for the Commission to reserve approval pending finalized construction plans. This PFD recommends that the capital expense projections for the business technology solutions category be reduced by $6.3 million to remove the projected test year expenditures.

[113] See 3 Tr 571 ("While the specific actions to be taken to remedy the current situation have not been finalized, the preliminary recommendation calls for a new primary data center that would be located in an area with fewer geographical risks.")

5. Smart Grid/AMI

The company projected capital expenditures for its smart grid program as shown in Exhibit A-47 of approximately $56 million for 2011 and $40 million for the first nine months of 2012. Ms. Trumble testified that the company's Smart Grid/AMI program was established in 2007, and that the company has completed Phase 1 of the program to date.[114] She testified that the company has also been actively working with other utilities, vendors and service providers to take advantage of lessons learned from their deployments, and to ensure that appropriate standards and technologies are developed. She also testified that Consumers has actively participated in the Commission's Smart Grid collaborative. She explained that the company is planning to begin deployment of Smart Grid/AMI technologies in distinct phases, while continuing to assess and validate the "business case" and benefits.

Phase 2 of the program includes the deployment of up to 460,000 electric meters and 5,000 gas meter modules during the period of 2012-2013, beginning in Muskegon and followed by Zeeland, North Kent, East Kent, West Kent/Grand Rapids, Allegan, and a portion of Kalamazoo. Exhibit A-43 shows the deployment schedule. In this case, she testified, the company is seeking funding for Phase 2 of its program as follows:

> Given that the projected year in this filing concludes at the end of September 2012, the Company is requesting approval of costs associated with the deployment of 72,000 electric meters, which represent meter deployments commencing in March 2012 through September 2012 in our Muskegon work headquarters area. Also, costs associated with an estimated 590 AMI network communications modules that support the meter deployment in Muskegon during the projected year period.[115]

[114] Ms. Trumble's Exhibit A-44 also reviews the findings from Phase 1.
[115] See 3 Tr 599.

Further discussing the goals of Phase 2, Ms. Trumble also presented the company's most recent "business case" or benefit/cost analysis of the project, completed in March of 2011 and presented in Exhibit A-45. She testified that the analysis shows a 20-year positive net present value of $38 million for the overall program, with the allocation of common infrastructure and other shared expenses, 14% to gas operations and 86% to electric operations. She further reviewed key benefits the company included in its analysis, as well as the capital and O&M cost assumptions.[116] Her Exhibit A-46 reviews the costs associated with Phase 1, while her Exhibit A-47 presented the electric and common capital projected expenditures for the projected test year. O&M expenses are projected in Exhibit A-48.

Mr. Jones also testified to certain accounting issues relating to the company's accounting for Smart Grid/AMI expenditures in light of the Commission's November 4 order in Case No. U-16191.[117] This is discussed in section VII below, along with Mr. Birkam's testimony on the same topic.

Mr. Hirsch testified to summarize the results of the company's 2010 Direct Load Management pilot, and its 2010 dynamic pricing pilots, and to explain how the company plans to use the pilot results and other information gathered by the company to ensure that customers benefit from the smart grid deployment.[118] He testified that during the summer of 2010, the company's "peak power savers" pilot program in the Grand Rapids area installed load controls on the air conditioners of 2200 volunteer customers. The company cycled the units on and off on a limited number of peak days in exchange for

[116] See 3 Tr 601-604.
[117] See See 4 Tr 968-972.
[118] See 3 Tr 373-382.

an appreciation payment to the customers and a modest rate reduction for a portion of their usage. Mr. Hirsch testified that based on the results of a telephone survey, and a focus group session, customer reaction was positive. In the “personal power plan” pilot program, dynamic pricing pilot, the company did not cycle customer units on and off, but 750 volunteer customers were divided into groups with different rates and technologies available to them. According to Mr. Hirsch, follow-up telephone surveys and focus groups showed customer satisfaction with the programs.

Exhibits A-18 through A-20 contain details on these programs and results. Mr. Hirsch testified that the company drew several conclusions from these pilots, including that customers respond positively; that direct load management results in approximately 1 kW potential load reduction per customer on a critical peak day, with little impact on customer comfort; that customers react to dynamic pricing programs in varying degrees; and that customers are motivated to participate in these programs to save money, to make a positive environmental impact and to be helpful. He explained that the company plans to use this information and information obtained through customer forums, workshops, and collaboratives to develop a “comprehensive vision and plan for customer education and engagement”, as shown in Exhibit A-21.

Staff witnesses Mr. Evans and Mr. Hudson testified to Staff’s review.[119] Mr. Evans explains that Staff supports the company’s proposed capital expenditures of $53.3 million for the 12-month period ending September 30, 2012.[120] He testified that although Consumers projected capital expenditures of $42.4 million for the first nine months of 2011, the Staff audit concluded actual expenditures were only $23.2

[119] See 5 Tr 1044-1055; 5 Tr 1057-1069.
[120] See 5 Tr 1048.

million.[121] Referring to Mr. Krause's testimony, he indicated that the lower actual expenditures were reflected in Staff's test-year beginning balance.[122]

Mr. Evans also testified to concerns with the company's cost projections, and with the company's benefit/cost analysis. First, Mr. Evans testified that he updated the company's analysis to reflect modifications the company planned to make in the fourth quarter of 2011, including elimination of the load control and demand response benefit, eliminating the estimated benefit associated with improved meter accuracy and increasing the estimated benefit associated with improved theft detection. He testified that as adjusted, the net present value of the project is estimated to be $34.5 million, with a total project revenue requirement of $807.5 million.

Mr. Evans also expressed a concern that multiple assumptions built into the company's analysis are overly optimistic, including the company's projected useful meter life, the lack of budgeting for contingency funds, and the assumed level of energy conservation among residential customers. Regarding the meters, he noted that the company had advised Staff that the meters are warranted by the vendor for 20 years, but explained that the warranty would not cover technical obsolescence, and reviewed the useful lives ranging from 10 to 15 years used by other utilities in setting depreciation rates for such meters. Because the budget does not have a contingency allowance, except for load control switches, he testified:

> A contingency is a reflection of a project's level of risk, and this approach seems to underestimate the level of risk of the Company's AMI / smart grid project. Some possibilities it ignores include the reasonable chance that various other components and software may need to be replaced

[121] See 5 Tr 1047-1048.
[122] See 5 Tr 1047-1055.

> early due to premature failure or obsolescence; that new and updated software may be needed to support future applications like prepayment, which is referenced in the Company's testimony but currently cannot be implemented by SAP; and that an increase in personnel may be warranted due to additional information technology work.[123]

And he explained that the company's analysis includes conservation benefits based on the company's estimate that 36% of its customers can be confidently classified as either "cost conscious" or "environmentally conscious", and that a majority of these customers (75%) will conserve energy if provided with usage information through the AMI system. He testified that this assumption was not adequately supported, and that the actual participation rate may be lower, reducing benefits. He also testified that actual benefits could be higher than estimated by the company, because they are difficult to quantify or predict.

Mr. Hudson testified to policy recommendations Staff is making to mitigate the risk to ratepayers, control costs, and help maximize the benefits of the project. Mr. Hudson testified that Staff is recommending full deployment of the project, consistent with the guidelines approved by the Commission in its November 4 order in Case No. U-16191. Additionally, Staff is recommending additional conditions including accounting measures addressed by Mr. Birkam, a cap on the amount of capital expenditures the company can add to rate base in any year, and a requirement that the company formulate a comprehensive statement regarding its deployment plan for grid modernization. He explained that the annual cap would be based on the level of actual and projected benefits, calculated in terms of the net present value of the accumulated and projected lifecycle benefits:

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[123] See 5 Tr 1053.

> The cost recovery cap will protect ratepayers because the cost recovery for AMI/smart grid related expenditures will be limited by the actual and projected life cycle benefits, thus holding ratepayers harmless should the company incur significant cost over-runs due to reasons such as imprudence, premature technological obsolescence, or improper program management. The principle behind Staff's proposed cap is that the existence of the cumulative capital investment threshold creates a risk to the Company that excess investment (defined as costs exceeding projected benefits and hence costs that are unreasonable and imprudent) will not be recovered by [sic] ratepayers. Thus, the cap should incentivize Consumers Energy to pursue cost containment as a means to reduce such risk.[124]

The comprehensive statement, which Staff would like filed within 90 days of the Commission's final order in this case, would contain information regarding the costs and benefits of the company's investments, timing, customer protections, and other details of the company's decision-making.

Mr. Coppola recommended that the Commission disallow the company's total capital expenditures on the smart grid program from 2007 forward through the projected 2012 expenditures, for a total adjustment of $168 million.[125] His testimony reviewed the company's past and proposed expenditures through 2019, for both the electric and gas operations of the company. In his opinion, the survey results described by the company following its pilot program show at best limited interest and mostly incomplete data. Discovery responses provided by the company regarding these results are included in his Exhibit AG-23. He also critiqued the company's benefit/cost analysis, contending that the company's analysis is based on the "regulatory approach" of measuring cash flows based on cost of service to customers with depreciation over a 15-20 year period. He testified that the company did not take into consideration the cost of debt, and made assumptions about cost savings from the technology with scant support.

[124] See 5 Tr 1062-1063.
[125] See 4 Tr 717-724.

Mr. Coppola presented an alternative benefit/cost analysis in his Exhibit AG-22, which he characterizes as a more traditional approach, using actual cash flows each year. The result of his analysis over a 25-year period is a negative net present value of $28.8 million, and an internal rate of return of 8.96%, below the company's proposed pre-tax cost of capital of 9.81%. To show the sensitivity of the results to the cost-saving assumptions, he also performed the calculations using estimated cost savings 25% below the company's assumptions, resulting in a negative net present value of $113.9 million. He concluded that for the company to continue with this project at this time will burden customers with higher rates for many years, and recommended that the Commission order the company to suspend further development and implementation work on the AMI project. He added the proviso that if the company continues to gather information about the industry experience with the technology, if the technology is proven and the costs fall, perhaps at that time, a benefit/cost analysis will show the project is beneficial to customers.

Mr. Merry addressed Mr. Coppola's benefit/cost analysis in his rebuttal testimony.[126] He testified that Mr. Coppola's Exhibit AG-22 analysis did not properly reflect the use of debt, by failing to reduce the initial investment by the debt amount, thus overstating the equity investment. In his rebuttal exhibit, Exhibit A-52, he revised the treatment of debt and equity, and testified that the resulting after-tax internal rate of return (IRR) of 13.22% shown by the revised analysis should be compared to the company's current and recommended return on equity of 10.7%

[126] 3 Tr 458-466.

Mr. Coppola also testified in surrebuttal to Mr. Merry's testimony, addressing the internal rate of return and net present value calculations presented in Exhibit A-52, and explaining the revisions he made to Exhibit AG-22 as a result of Mr. Merry's rebuttal testimony.[127] He testified that Mr. Merry made certain assumptions that are not reflective of how the company usually finances its capital projects, including the assumption that debt repayment would begin in year 10, and the assumption that the company could finance the project on a standalone basis. He further testified that a better analysis of the project is to consider the actual annual expenditures for the project in its entirety, reduce the cash outlays by the after-tax cost savings of the project, and discount the net cash flows by the company's overall pre-tax cost of capital, as presented in his Exhibit AG-22.

Mr. Merry also presented "supplemental rebuttal testimony" addressing Mr. Coppola's revisions to his Exhibit AG-22, and further revising that analysis in his Exhibit A-71. He testified that Mr. Coppola wrongly compared the IRR resulting from his analysis, which Mr. Merry testified is clearly on an after-tax basis, with the company's pre-tax cost of capital. Using the after-tax cost of capital of 7.22% based on the company's proposal/proposed cost of capital calculations in Exhibit A-9, Mr. Merry testified that the IRR of 8.96% shows the project is financially viable, with a net present value of $68.9 million. He also addressed Mr. Coppola's testimony that the debt repayment assumptions in the analysis are unrealistic, arguing that assumptions must be made, and that the analysis would reach a similar result if the assumptions were varied.

[127] See 4 Tr 768-770.

Mr. Hirsch presented rebuttal testimony to dispute Mr. Coppola's conclusions regarding the company's pilot program survey results. He explained how customers responded in the dynamic pricing pilot by increasing air conditioner temperature settings, turning off unnecessary lighting, unplugging appliances and postponing laundry, and reported additional customer responses to show that customers viewed the programs favorably and took active steps to reduce their energy usage.[128]

Mr. Rasmussen also presented rebuttal testimony on this issue, addressing Staff's proposed cost recovery cap as follows:

> Once a decision is made and a cost incurred, however, it is not reasonable to later impose a disallowance based on changed circumstances. Such an approach to recovery of AMI/smart grid expenditures would be a different, more onerous standard than has ever been required for any other type of utility investments. Another concern with the Staff's proposed recovery cap is that investments already approved for inclusion in rates would be at risk for future disallowance if the value of some estimated future benefit does not materialize as expected. Not only is this unfair, the Company believes that this is a "hindsight" approach to ratemaking and is contrary to established legal principles. Further, the mere potential of a future Commission denying recovery of all or some portion of previously approved Smart Grid/AMI investment that had already been placed in commercial operation would force a serious reevaluation of whether to proceed with any investment at all.[129]

In his briefs, the Attorney General relies on Mr. Coppola's testimony in recommending the full disallowance of all past and projected Smart Grid/AMI expenditures. The Attorney General emphasizes Mr. Coppola's criticisms of the assumptions underlying the company's benefit/cost analysis. The Attorney General argues that in its rebuttal testimony, Consumers addressed only issues involving customer responses to the pilot program and the net present value/internal rate of

[128] See 4 Tr 383-388.
[129] See 3 Tr 108.

return calculations (NPV/IRR), but did not address the flaws Mr. Coppola identified in the underlying cost assumptions. The Attorney General argues that faulty inputs and assumptions fail to show that the benefits exceed the costs of the program.[130]

ABATE argues that based on Mr. Coppola's analysis, the Commission should find that the AMI/Smart Grid project is not economically viable, and order an immediate suspension and denial of recovery.[131] ABATE cites Mr. Coppola's testimony regarding the company's dynamic pricing pilot, arguing that the company's pilot program did not validate the savings assumptions included in the company's benefit/cost analysis.

The Michigan Utility Workers Council filed a reply brief also addressing its concern with the proposed AMI/Smart Grid project expenditures. It cites the Commission's August 22 and October 4, 2011 decisions in Case No. U-16418, determining that the company failed to make a convincing business case for the continued deployment of gas AMI, and refusing to provide a rate increase to support the gas AMI program. It also focuses on testimony from Ms. Trumble indentifying differences between the deployment plan reviewed in Case No. U-16191 and the one presented in this case, arguing that the company's program is still a "work in progress." And the Michigan Utility Workers Council cites Mr. Coppola's testimony.

Staff's brief comprehensively addresses the company's proposal, including detailed discussion of Staff's accounting, rate cap, and filing recommendations.[132] Staff's brief reviews Mr. Evans concerns regarding the company's projections and business case/benefit/cost analysis, as discussed above. Regarding the capital

[130] See Attorney General brief, pages 20-27.
[131] See ABATE brief, pages 25-27.
[132] See Staff brief, pages 74-85.

expenditures, Staff recommends a reduction in the company's proposed spending for the first nine months of 2012, indicating that since the company filed its case, it made changes to its business case and project timeline, including a delay in the installation of AMI in the Muskegon area. Staff references Exhibit S-17 to show the revised plans. Staff argues that although the company indicates it plans to spend the same amount, that the company has not supported this assertion. On this basis, Staff recommends $8.5 million in capital and $4 million in O&M expense reductions to the company's projections. Staff's reply brief further characterizes the expenditures presented in Exhibit A-47 as out of date, and recommends that the Commission rely on Exhibit S-17.

Regarding Staff's proposed cost recovery cap, Staff's brief addresses the company's rebuttal testimony, indicating that the company has misunderstood Staff's proposal, and that the proposal is consistent with the standard prudency reviews the Commission conducts:

> Staff urges the Commission in future rate cases to make an assessment of the costs that Consumers requests to be included in rates, and to determine if the benefits associated with those costs, warrant their inclusion in rates. This is a classic prudency review of a rate application and involves no hindsight reviews.[133]

Staff further addresses its cap proposal in its reply brief by emphasizing that there is inherent uncertainty in several of the assumptions contained in the company's benefit/cost analysis, arguing that it is the same as the cap the Commission imposed on Detroit Edison in Case No. U-16472, and indicating that Staff plans for the possibility that it will recommend downward adjustments in future rate cases to ensure that the total costs of the project paid by ratepayers do not exceed the benefits received.

[133] See Staff brief, pages 80-83.

In its brief, the company argues that the Smart Grid/AMI program represents a key initiative in its overall business strategy, and reviews the evolution of its deployment.[134] The company also notes that the capital expenditures projected in Exhibit A-47 have been prorated to reflect only the electric portion. The company relies on the benefit/cost analysis presented in Exhibit A-45.

The company also addresses Staff's proposed cap on expenditures, arguing that a project of this magnitude should not be subject to hindsight review, and citing Mr. Rasmussen's rebuttal testimony. Addressing the Attorney General's recommendations, the company relies on Mr. Hirsch's testimony regarding the success of the pilot programs, and Mr. Merry's testimony regarding benefit/cost analysis, discussed above.

In its reply brief, the company confirms that it accepts Staff's recommended downward adjust to the company's beginning CWIP balance because actual expenditures to the starting point of the projected test year had been below projected capital expenditures, but continues to challenge Staff's recommended $8.5 million reduction in the company's capital expense projection due to delay in meter deployment from March 2012 to September 2012. Citing Exhibit S-17, the company argues it has demonstrated that additional systems to implement the smart grid system have been added to the proposed capital expenditures for the test year.

And reviewing Staff's initial brief regarding Staff's proposed cost recovery cap, Consumers argues that Staff's proposal is unfair, a "hindsight" approach to ratemaking, and contrary to established legal principles:

[134] See Consumers initial brief, pages 23-34.

> What Staff proposes is that the Company bear all cost/benefit risk associated with the inherent uncertainty of predicting the future, and accomplishes this by making the company effectively *guarantee* the cost/benefit projections come true. This is especially bad policy, particularly given that the Company is not even in control of all factors that will influence total costs of the project or the total benefits that will be realized. For example, there has recently been growing pressure to allow customers to "opt-out" of the AMI program. To the extent such a policy was adopted, it may negatively influence the immediate cost savings that can be achieved from the project, and will certainly decrease the long-term benefits that underlie the project. Similarly, to the extent service offerings approved by the Commission allow customers to fail to take advantage of the savings that are achievable from SG/AMI, those long-term benefits are also put at risk. It is simply unreasonable and unfair policy to require the Company to guarantee an outcome when it does not have control over all the elements influencing that outcome. Even acknowledging there could not be an adjustment in rates for expenditures already incurred cannot cure Staff's hindsight analysis.[135]

The company also argues that Staff's proposed filing requirements are unnecessary, voluminous and burdensome. The company argues that it already keeps Staff well informed regarding its plans and progress, and also notes that the Commission opened a docket, Case No. U-17000, which requires the submission of much the same information as requested by Staff.

<u>Discussion</u>

The Commission has clearly expressed support for the advancement of the Smart Grid/AMI in principle. Staff likewise has explained that the technology offers promising potential. In its November 4 order in Case No. U-16191, the Commission adopted the following guidelines for the company's AMI expenditures:

1. Piloting phase expenditures are classified into two categories: a) those directly related to the piloting function, e.g. testing, and b) those actually related to the full deployment.

[135] See Consumers reply brief, pages 45-46.

2. Direct pilot expenditures are deemed recoverable expenses irrespective of whether or not the pilot indicates a go-forward decision.

3. A cost/benefit analysis is not required as a precondition for cost recovery of direct pilot expenses. However, the utility must demonstrate that the costs were reasonably required to fulfill the objectives of the pilot.

4. Because the financial risk associated with the Smart Grid pilot is borne by ratepayers, it is incumbent upon the utility to keep pilot costs as low as reasonably possible.

5. Prior to the completion of the pilot, capitalized expenditures will be included in utility rate base as Construction Work in Progress (CWIP) with an Allowance for Funds Used during Construction (AFUDC) offset. Capitalized expenditures directly related to the pilot will not be reflected in rates until the pilot phase is concluded.

6. Smart Grid capitalized expenditures directly related to full deployment, but incurred during the pilot phase of the project are subject to the "used and useful" ratemaking principle. Thus, if full deployment is not approved by the Commission, full deployment costs incurred during the pilot phase of the project are not recoverable from ratepayers.

7. Commission approval of full deployment means that the Commission supports a utility's decision to move the project out of the pilot/testing phase into final deployment.

8. Commission approval of Smart Grid full deployment means that the Commission will not re-evaluate the utility's initial decision to move forward with a system-wide infrastructure deployment midway through the full deployment phase.

9. Commission approval of full-deployment does not guarantee cost recovery of future expenditures. CE will remain responsible to support individual expenditures for reasonableness and prudence. Such regulatory policy protects customers from having to bear the cost of unreasonable cost overruns, unnecessary expenditures, project "gold plating" or imprudent project decisions.

10. The project risk is borne by stockholders. Thus, subsequent to the full deployment phase, i.e. during the project lifecycle, and to the extent that the utility is not able to achieve benefits equal to or greater than lifecycle costs, then to such extent, full deployment expenditures are not "used and useful" and thus not recoverable from ratepayers.

11. Commission approval of Smart Grid cost recovery of full deployment must be pre-conditioned upon: a) CE achieving all major pilot milestones; b) demonstration that a full business case, (i.e. detailed lifecycle cost/benefit

> analysis) supports full deployment; and c) the filing of a comprehensive plan for specific customer programs that ensure that customers can obtain savings to offset the cost of Smart Grid infrastructure for which recovery is being requested.[136]

Further, the Commission explained:

> In accordance with the guidelines proposed by the Staff, capitalized expenditures directly related to the pilot will not be reflected in rates until the pilot phase is concluded and Consumers has provided a final report to the Commission detailing the milestones that were achieved and not achieved, decisions regarding functionality, and any other relevant information or decisions made through the piloting process. This report will facilitate the Commission's decision making process with respect to the appropriateness of requiring customers to bear the costs of moving out of the piloting phase into full deployment.[137]

Until now, Consumers has pursued development of the smart grid through its pilot phase only. In this case, Consumers is asking for approval to begin full deployment, starting with its "phase 2" as described above, and seeks to include projected test year capital expenditures of approximately $53 million in rates.

Although the company's benefit/cost analysis as reviewed by Mr. Evans shows a net present value of approximately $35 million, all parties addressing this issue acknowledge some concerns with the underlying assumptions. Even the company acknowledges concerns in addressing Staff's proposed cost recovery cap, as quoted above.[138] To recap, these concerns include the lack of any contingency for cost overruns or unanticipated costs in the benefit/cost analysis, assumptions about customer participation that are based only on customers who voluntarily participated in pilot programs, assumptions about meter life that are not consistent with lower projections used by other utilities, and the company's expressed concerns that if

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[136] See November 4 order, pages 16-17.
[137] See November 4 order, page 19.
[138] See Consumers reply brief, pages 45-46.

customers opt out or are given the option not to take advantage of all of the savings potential associated with the technology, the net present value of the investment will be negative.

As a second area of concern, Staff's proposal to protect ratepayers from the risks associated with these and other assumptions is not acceptable to the company. As stated above, Consumers flatly opposes Staff's cost recovery cap. The company's briefs do not acknowledge or address the Commission's October 20, 2011 order in Case No. U-16472, which adopted a cost recovery cap for Detroit Edison's Smart Grid/AMI investments that appears to be the same as the one Staff is seeking here:

> The Commission finds that the Staff's recommendation to cap Detroit Edison's recovery of cumulative historical and projected capital expenditures at the level of projected lifecycle benefits is a reasonable one, providing an effective means of cost control and a meaningful way to incentivize the company to assure that the benefits of AMI to ratepayers are maximized.[139]

Moreover, in that case the Commission found that the cost recovery cap it was imposing on Detroit Edison was similar to the one already in place for Consumers Energy:

> The commission notes that a similar limitation has been put in place for Consumers' AMI program: "The project risk is borne by stockholders. Thus, subsequent to the full deployment phase, i.e. during the project lifecycle, and to the extent that the utility is not able to achieve benefits equal to or greater than lifecycle costs then to such extent, full deployment expenditures are not "used and useful" and thus not recoverable from ratepayers."[140]

In expressing its opposition to Staff's cost recovery cap, the company essentially asserts that if the cost recovery cap is imposed on the program, it will not undertake the expenditures:

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[139] See October 20, 2011 order, pages 23-24.
[140] See October 20, 2011 order, page 24 at n2, quoting guideline 10 also quoted above.

> The company would better meet its fiduciary obligations to investors and customers to cancel the project even with its positive anticipated customer benefits to avoid the risk of Staff's cost recovery cap.[141]

Another concern with the company's proposal is that Phase 2 includes the installation of gas meters, and some of the costs the company is proposing for recovery in this case include common costs allocated to both electric and gas operations on a percentage basis, 86% to electric, 14% to gas.[142] In its August 11, 2011 order in Case No. U-16418, Consumers' last gas rate order, the Commission rejected the company's claim that gas customers would benefit from the Smart Grid/AMI expenditures, finding that "Consumers again failed to make a convincing business case for the continued deployment of gas AMI."[143] Granting the utility's petition for rehearing on that order, the Commission agreed that the portion of that order requiring a rate adjustment was erroneous, given the settlement agreement among the parties to that case, but the Commission did not alter its conclusion regarding the company's business case for gas AMI. The Commission's October 4, 2011 rehearing order instead indicated: "Consumers adds that in recognition of the Commission's concerns regarding gas AMI, it intends to remove all costs associated with the gas program from its next general rate case application."[144] The company's brief notes that its spending plan includes an allocation of common costs, but does not discuss the Commission's decisions in Case No. U-16418. Note that the Commission's decisions in this case were issued after the company filed its testimony in this case.

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[141] See Consumers reply brief, page 46.
[142] See, e.g. Trumble, 3 Tr 605.
[143] See August 11, 2011 order, page 12. The Commission also referenced the guidelines adopted in Case No. U-16191, quoted above.
[144] See October 4, 2011 order, page 3.

Because the record reflects significant unresolved concerns about the reliability of the company's benefit/cost analysis, because the company's objection to Staff's cost recovery cap also suggests that the company is not committed to the project even under the guidelines already approved in Case No. U-16191, and because the company has not addressed how Commission approval of the cost recovery requested in this case is consistent with the company's commitment not to seek cost recovery from gas rate payers in its next gas rate case or with the Commission's conclusion in Case No. U-16418 that the company had not justified AMI for gas operations, this PFD recommends that the Commission defer approval of the company's movement into phase 2. A deferral to a subsequent rate case or more limited proceeding should give the Commission the opportunity to review a benefit/cost analysis that shows the sensitivity of the end result to the underlying assumptions, to identify appropriate ratepayer protections that also give the Commission a solid basis to conclude that amounts authorized for the program will be spent on the program, and to ensure that no misunderstanding arises regarding cost approval for the company's gas operations. Note, too, that in its January 12, 2012 order in Case No. U-17000, the Commission called for additional information from all regulated utilities including: plans to deploy smart meters and sources of funding; estimated costs of deployment, estimated savings and non-monetary benefits; and information on the costs of customers opting out of having a smart meter.

This recommendation leads to the recommended exclusion of the company's projected capital expenditures for the test year of $53.3 million. The recommendation, if adopted by the Commission, is not intended to constitute a determination under guideline 6 that full deployment is disapproved.

6. Clean Coal Plant

The company presented multiple witnesses regarding its proposal to recover the $21.7 million planning costs associated with its Clean Coal Plant project. At the time the company filed its direct case, it had announced that it had suspended plans to construct the plant, but had not canceled the project.

Mr. Jones testified to the company's accounting for the plant costs to date, and its proposed accounting, under which the company would recover the costs that would have been capitalized had the plant been built over a three year amortization period.[145] He testified that the company's costs were recorded as CWIP, until the fourth quarter of 2010, following the May 2010 deferral announcement. At that point, he testified, "management determined that the likelihood that the plant would be constructed had diminished significantly and decided to expense the remaining clean coal plant CWIP expenditures." He testified that the decision to expense the costs was in accordance with accounting standards, but that the company proposes to recover the costs from customers by creating a regulatory asset for the authorized recovery amount and amortizing the regulatory asset over 36 months. His testimony details both the current accounting and requested accounting for those costs, by account number. He testified that Mr. Kehoe provided the more detailed explanation of plant-related expenditures, and Ms. Rolling provided the more detailed explanation of the company's proposed cost recovery.

[145] See 4 Tr 965-968.

Mr. Kehoe testified to the expenditures the company incurred in planning the Clean Coal Plant, shown on his Exhibit A-31. He testified that the company used a competitive bidding process for all expenditures over $10,000. He testified that the expenses incurred were reasonable and prudent because they followed the 21st Century Energy Plan issued under Executive Directive 2006-2, which he discussed in greater detail. Shortly after the plan was issued, he testified, Consumers Energy filed an application for approval of its "Balanced Energy Initiative", Case No. U-15290. He explained that the utility did not file for a Certificate of Need, but "completed much of the due diligence required for filing the CON", deferring the project before the CON was filed.

Mr. Kehoe testified that the company reasonably decided to defer the project because the load growth projections identified and forecast in the 21st Century Energy Plan were no longer accurate due to the recession, and market conditions included excess generating capacity and low spot market electric prices. He also testified that the drop in natural gas prices influenced the company's decision, lowering the cost advantage of coal as compared to gas.

Ms. Rolling also testified to the proposed accounting treatment for the Clean Coal Plant expenses. She testified that a three-year period reasonably balances the company and customer interests, asserting that the majority of the expenditures were incurred in the three-year period prior to the deferral decision. She also testified that recovery in a timely manner will help the company attract capital for future expenditures, and would have an annual impact on a typical residential customer of only approximately $1.77. She explained how the Clean Coal Plant costs are included in the company's revenue requirements: one-third of the $21.7 million total to be recovered is included as an expense in Exhibit A-8, Schedule C-6; the remaining amount is included in Exhibit A-7, Schedule B2, as a regulatory asset in rate base. She testified that because the company invested corporate capital in the plant for the benefit of its customers, it should receive a return on those funds until they are recovered. She also testified this recovery is consistent with the ratemaking treatment for these expenses in Case No. U-15645 and U-16191, in which the plant costs were recorded in CWIP. Acknowledging the Commission's decision in its November 4 order in Case No. U-16191, she testified that the Commission's order excluded only projected costs for 2010 and 2011 from rate base.[146]

Ms. Rusnak, Mr. Birkam, and Mr. Krause testified for Staff. At the time Staff and intervenors filed their testimony, the company had sought and obtained an 18-month extension of its permit to construct the plant, granted in July, 2011. Ms. Rusnak testified that given that the uncertain status of the project, the company should not be seeking recovery at this time. Instead, she testified, if the plant moves forward the costs would become part of the total plant costs, while if not, the company could seek recovery at a later date.[147]

Mr. Birkam testified in response to Mr. Jones's direct testimony regarding the accounting for the Clean Coal Plant expenditures. He recommended that the entire amount of $23,975,151 that was previously in CWIP be placed into a deferred debit account in the "investor supplied" column of the Company's Exhibit A-2, Schedule B-5, for ratemaking purposes. This accounting would stay in place until the plant is

[146] Also see her Exhibit A-65, presented in rebuttal and discussed below.
[147] See 5 Tr 1163-1164.

abandoned or construction resumes. Mr. Birkam testified that based on the company's decision to suspend rather than abandon the project, Staff's proposed accounting is more reasonable. Mr. Birkam also explained why alternative accounting treatment, such as allowing the plant costs to remain as CWIP with an AFUDC offset, or using a Plant Held for Future Use account, would not be appropriate. Mr. Krause also testified that Staff removed the Clean Coal Plant expenditures from its rate base calculations.[148]

Mr. Selecky testified for ABATE, recommending that the Commission reject cost recovery of the Clean Coal Plant expenditures because they did not result in any asset that is used and useful in supplying service. He also points out the company did not seek a certificate of need from the Commission. Should the Commission determine that some sharing of the costs between the company and its customers is appropriate, however, Mr. Selecky recommended that the Commission adopt a five-year amortization period, and deny rate base treatment for the unamortized balance. He also recommended that the company not be allowed to recover approximately $4.86 million incurred after mid-year 2009. In support of this recommendation, he cited Mr. Kehoe's testimony indicating that Consumers was aware in 2008 and 2009 that excess generating capacity and low spot market electric prices were commonplace across the country.

Mr. Peloquin testified for MCAAA, recommending that the Commission reject the company's amortization proposal.[149] Instead, without taking a position on the reasonableness and prudence of the company's expenditures to date, he recommended that the Commission use a ten-year amortization, and not permit the company to earn a

[148] See 5 Tr 1077.
[149] See 6 Tr 1545-1548.

return on the unamortized portion. He testified that the ten-year amortization he proposed is consistent with the amortization of Consumers' Midland Nuclear Power Plant, and with the amortization period used for MGP expenses. Noting too that the company's recovery under the amortization would not terminate precisely at the end of the amortization period, he testified: "In the likely event that Consumers over-collects its Clean Coal Plant investment, I would prefer that Consumers over-collects at the rate of $2.1 million per year rather than $7.3 million per year."[150]

Ms. Richards also testified regarding the company's proposed recovery of the Clean Coal Plant costs.[151] Reviewing Mr. Kehoe's direct testimony, she testified that she disagreed with the company's proposal to amortize the costs of the Clean Coal Plant, arguing that it was premature because the costs had not been vetted in any proceeding. She recommended that the dollars invested remain in a holding account until the company decides to move ahead with the project or abandon the plant development. She also recommended that Consumers not earn a return on development and planning expenses in the event it decides not to build the plant. She testified that the load growth projections the company used for its 2007 Balanced Energy Initiative proved to be inaccurate, yet the company continued to invest in the plant: "As with any investment, investors bear the risk of an investment "going sour."[152]

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[150] See 6 Tr 1547.
[151] See 6 Tr 1478-1481.
[152] See 6 Tr 1481.

Mr. Kehoe's rebuttal testimony identified the company's revised plan to cancel the Clean Coal Plant project outright, announced on December 2, 2011.[153] Referencing Ms. Rusnak's testimony that the company had not made a final decision, he testified:

> "The only precondition stated by the MPSC staff for delaying recovery of these costs was an official announcement of the status of the plant. That announcement has been made. . . . I will note that, as explained in my direct testimony, the preliminary planning costs at issue in this case were prudently incurred, and are therefore recoverable regardless of whether the plant was completed or cancelled. Nevertheless, the official cancellation of the plant resolves the only objection raised by the Staff.[154]

He testified that Staff and MEC/NRDC had not challenged the prudence, timing or amount of any expenses related to the project, and repeated his initial testimony that those costs were reasonably and prudently incurred as a result of recommendations made in the 21st Century Energy Plan and Capacity Needs Forum. Mr. Kehoe testified that the company's decision to cancel the plant was also prudent: "Consumers Energy initially delayed the new coal plant because of conditions described in my direct testimony. Those conditions now appear likely to continue, therefore the prudent action was to cancel the plant."[155] He addressed Mr. Selecky's proposal to exclude costs from mid-2009 forward by asserting that his recommendation was based on hindsight, and that: "Consumers Energy had no way of knowing how long the economic conditions would last or how long a full economic recovery would take." Therefore, he testified, "the Company prudently continued to move forward until it became apparent that deferral was the most prudent action to take."

[153] See 6 Tr 1338-1339, 1353-1354, 1356.
[154] See 6 Tr 1338.
[155] See 6 Tr 1339.

Mr. Jones testified on rebuttal principally in response to Staff's recommended accounting for the Clean Coal Plant costs. [156] He testified that the cancellation of the plant did not alter his direct testimony in its key points. He testified that the primary difference between the $21.7 million the company seeks recovery of and the $24 million Staff recommended be placed in a deferred debit account is attributable to $1.8 million in land costs. Because the company still has a plan for the land, to facilitate operations at the Karn/Weadock generating complex, he testified that the land can still be considered plant held for future use. He also testified that MISO refunded $.5 million in deposits made by the company for MISO system impact studies, and this refund should be recognized. He testified that if the Staff's proposal to transfer the costs to a deferred debit account is adopted, the Company requests an offsetting reserve be established, pending MPSC approval of the costs for recovery.[157]

In her rebuttal testimony, Ms. Rolling also testified regarding the company's December 2, 2011 decision to cancel the plant.[158] She relied on Mr. Kehoe's testimony to establish the reasonableness and prudence of the company's decision-making, and testified that Staff had not presented any evidence to the contrary: "While it would not have been reasonable to conclude that ratemaking recovery could only begin if the Plant is cancelled, now that the decision has been made to cancel the Plant this objection has been resolved."[159] She emphasized that the company is only seeking recovery of planning costs, and again indicated that these costs were already included in rate base, in CWIP, presenting Exhibit A-65 to support her testimony. She also

[156] See 4 Tr 981-983
[157] See 4 Tr 983.
[158] See 3 Tr 189-195.
[159] See 3 Tr 191-192.

testified that the three-year amortization period recommended in her initial testimony is more reasonable than the five-year and ten-year periods recommended by Mr. Selecky and Mr. Peloquin respectively. Mr. Rasmussen also testified to the reasonableness of the Clean Coal Plant costs "from a policy perspective."[160]

In its brief, MEC/NRDC argues that the company should not recover the coal plant costs because it has not established that its load projections were reasonable when they were made, or explained why it seeks to recover 100% of the costs from ratepayers when the company planned to have non-customer partners that would receive approximately one-third of the benefits of the plant.[161]

MEC/NRDC argues that although Consumers blames the decline in load on the recession, its forecasting methodology is flawed, citing testimony of Ms. Richards. MEC/NRDC further disputes the company's assertion that none of the parties challenged the prudence, timing, or amount of expenses related to the plant. MEC/NRDC argues that because Mr. Kehoe was not involved in the planning process for the coal plant, his opinion that the costs were reasonable and prudent when incurred was based only on his involvement with the Capacity Needs Forum and the 21st Century Energy Plan. MEC/NRDC argues that Consumers knew the forecasts on which those reports were based were inaccurate, asserting that the company's actual sales figures during the time it was making the planning expenditures were substantially at odds with the forecasts. In support of this assertion, MEC/NRDC cites Mr. Warriner's Exhibit A-10, showing changes in sales by year from 2006 through 2009, and Mr. Kehoe's testimony at 3 Tr 1397-1398 acknowledging that the company was aware that the actual load

[160] See 3 Tr 105.
[161] See MEC/NRDC brief, pages 28-38.

growth was different than the assumptions underlying the reports and the company's projections. MEC/NRDC also cites NRD-62, showing that during the period of declining sales growth from 2007 to 2009, the company spent over $17 million on the plant.

The Attorney General argues from a somewhat different perspective, contending that the company made the decision to spend the bulk of the money spent on the plant sometime in 2004.[162] Thus, the Attorney General argues that the company cannot rely on the 21st Century Energy Plan that was issued in 2007 to demonstrate that its decision was reasonable.[163]

Staff, originally taking the position as discussed above that because the project was suspended, review should be deferred, argues in its brief that deferral is still appropriate:

> Consumers' abandonment of its plans to construct a clean coal plant will allow Staff an opportunity to review all of the associated costs for prudence and appropriateness for their inclusion in Consumers' next electric rate case before the Commission. Deferring the recovery of these costs until a Staff review will avoid recovery of inappropriate costs.[164]

Nonetheless, Staff argues, should the company press the Commission for a decision on the recovery, then recovery should be denied for four reasons. First, Staff argues that the decision to begin planning the plant was the company's. Second, Staff argues that many of the expenditures are egregious, citing an expenditure of $5.74 million designated "employees", and an expenditure of $1.686 million designated "outside legal", among others.[165] Third, Staff notes, as MEC/NRDC does, that only two-thirds of the plant output was intended for the company's customers. Fourth, Staff argues that

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[162] See Attorney General brief, page 52, citing 3 Tr 116-118, 179.
[163] See Attorney General brief, page 52.
[164] See Staff brief, page 18.
[165] See Staff brief, page 19.

the company has not established any benefit to the company's customers from the expenditures.

MCAAA argues that the company's request for recovery "should be denied or greatly reduced or modified." MCAAA cites Mr. Peloquin's testimony, discussed above, emphasizing that none of the expenditures resulted in used and useful plant, and arguing that the three-year amortization unreasonably escalates the rate impact. MCAAA also argues that the company's proposal does not provide for any sharing of these costs and thus does not balance the interests of shareholders and ratepayers. To MCAAA, the Commission adopted a sharing approach for the Midland Nuclear Power Plant that was affirmed in *ABATE v Public Service Commission*, 208 Mich App 248 (1994), app den 450 Mich 892 (1995). MCAAA characterized Mr. Peloquin's ten-year amortization proposal as a liberal approach in favor of Consumers. MCAAA also argues that a rationale offered by the company, that the bulk of the expenses were incurred over a three-year period, does not justify the three-year amortization, since the costs were incurred over a six year period.[166]

MCAAA's brief also reviews MCAAA-5, showing a breakdown of the expenses at issue by year. MCAAA argues that although Consumers claims it decided to start building the plant because of the 21st Century Energy Plan issued in late May, 2007, Exhibit MCAAA-5 shows substantial expenditures in 2007 and prior:

> The chart in Exhibit MCAAA-5, page 2, listing the date and subject of signed contracts or purchase orders also shows the bulk of the contracts dealing with site studies and permitting were entered into in 2005 and 2006, with an engineering contract entered into on January 15, 2007. This information demonstrates that CECO's decisions and actions to commence development of the Clean Coal Plant occurred considerably

[166] See MCAAA brief, page 6, citing Exhibit MCAAA-5 and Rasmussen, 3 Tr 115-120.

> before the 2007 21st Century Energy Plan and not based upon reliance thereon. CECo's attempt to prove that it was reasonable and prudent to start development of the plant based upon reliance on the 21st Century Energy Plan is thus misplaced and unpersuasive.

MCAAA cites *Union Carbide Corp v MPSC*, 431 Mich 155 (1988), arguing that the decision to proceed with plant development rests with the utility management. MCAAA also cites testimony of Mr. Rasmussen acknowledging that the 21st Century Energy Plan is not itself a sufficient basis for recovery. And MCAAA argues that the company had early warnings that it would not need the new coal plant, given sales information in 2007, as shown in Exhibit MCAAA-10.

MCAAA also takes issue with the company's reliance on the inclusion of some of its Clean Coal Plant costs in rate base in Case No. U-16191. Citing Exhibit MCAAA-8 to show what was in front of the Commission in that case, MCAAA argues that the Commission's decision to exclude $14.5 million in projected costs from rate base was based on the information presented to the Commission at the time, and did not constitute a determination that the prior expenditures should be recognized in rates.

ABATE argues that the Commission should deny recovery, or adopt Mr. Selecky's sharing recommendation, as discussed above.

In its briefs, Consumers argues that it has established that its decisions to incur the costs, and to defer and then cancel the plant were reasonable and prudent.[167] Citing the testimony and exhibits of Mr. Kehoe, Mr. Jones, and Ms. Rolling, Consumers summarizes its argument as follows:

[167] See Consumers initial brief, pages 109-118.

- Consumers Energy invested corporate capital in the Clean Coal Plant and should receive a return on those funds until they are recovered from customers;

- Rates established by the Commission in its orders in Consumers Energy rate Case No. U-15645 and Case No. U-16191 included booked Clean Coal Plant costs in rate base;

- In Case No. U-16191 the Commission excluded $14.7 million of projected costs for the Clean Coal Plant in light of the decision to defer the plant, but did not remove the approximately $20 million of already incurred booked Clean Coal Plant costs from rate base;

- Including the unamortized balance in rate base is consistent with current ratemaking;

- Including the unamortized balance in rate base helps assure that the Company and its investors are not harmed by prudently made decisions to defer and to ultimately cancel development of the Clean Coal Plant based upon changed conditions.[168]

The company characterizes its cancellation of the project as a resolution to Staff's only objection, arguing there is no reason to defer granting the company's request. Regarding ABATE's analysis, Consumers argues that denying recovery because the plant did not go into service would tend to discourage utilities from engaging in prudent planning activities. The company argues that investors had a reasonable expectation that costs would be recovered if prudently incurred, at odds with Mr. Selecky's testimony that investors are compensated for risks associated with their investments. And the company took issue with ABATE and MCAAA recommendations to extend the amortization period beyond the three-year period requested by the company, arguing that the three-year period is more reasonable given the amount at issue. And the company restates Mr. Kehoe's characterization that ABATE's proposed reduction in the amount of recovery is based on hindsight.

[168] See Consumers initial brief, page 114.

In its reply brief, the company addresses Staff's recommendation by contending that Staff "actually did have time to review all of the associated costs for the Clean Coal Plant," but decided not to do so.[169] The company argues there is no record basis for Staff's claim that the company's expense levels are egregious, citing Exhibits A-31 and S-19.

Addressing arguments that the plant was planned in part to serve non-customers, the company argues that the plant was sized to take advantage of efficiencies of scale, and that the planning costs could not have varied if a smaller plant were planned. To the company, the contention that ratepayers should only pay a proportionate share of the costs "penalizes" the company for attempting to plan the plant in a manner that would benefit customers.

The company further cites the discussion of the "prudent investment test" in *ABATE v Public Service Commission*, 208 Mich App 248 (1994), app den 450 Mich 892 (1995), in support of its claim to recovery. It argues that denying initial planning expenditures if a plant is not completed "would create a perverse incentive to complete plants not needed", and argues that Michigan has a long history of allowing rate recovery of reasonable and prudent expenditures incurred for plants that were canceled, including recovery of actual construction costs.

Addressing the MEC/NRDC argument that the company's load growth projections were unreasonable, the company argues that load growth was projected by the 21st Century Energy Plan and by the Capacity Needs Forum, and that it is only in hindsight that those projections turned out to be inaccurate.

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[169] See Consumers reply brief, pages 51-61.

In its reply brief, MEC/NRDC argues that the record supports denial of the Clean Coal Plant cost recovery outright, but also indicates that Staff's recommendation to defer the decision is reasonable.

Discussion

In its November 4 order in Case No. U-16191, the Commission required the company to remove the costs of the plant from net plant and rate base:

> As the Attorney General pointed out, Consumers has included $14.7 million in 2010 and 2011 for preliminary work on a new generation facility, despite the fact that the company has decided to defer indefinitely the construction of the new plant.[170]

When it filed this case, the company had decided only to defer construction of the plant. At that point in time, Staff's recommendation to defer consideration of cost recovery until a decision was made was eminently reasonable. The company claims that it did not reach its final decision to cancel the plant until the date its rebuttal testimony was due, but claims as a result that Staff should be deprived of the opportunity to further review the company's expenses for reasonableness and prudence:

> Staff actually did have time to review all of the associated costs for the Clean Coal Plant. In the Company's initial filing (June 10, 2011) recovery of costs for the Clean Coal Plant were requested by the Company. The Company filed testimony and exhibits detailing the type, amount, and reasonableness of the costs of the Clean Coal Plant. 6 Tr 1327-1331, Exhibit A-31 (DBK-6). Staff filed testimony and exhibits five months later on November 15, 2011. Staff could have reviewed the costs of the Clean Coal Plant and presented testimony concerning these costs, but decided not to do so.[171]

This PFD recognizes that these rate cases must proceed in an orderly fashion. Staff's recommendation in this case was a reasonable one, and allowed it to spend time

[170] See November 4 order, page 13
[171] Consumers reply brief, pages 51-52.

on numerous other issues presented by the company's filing in this case. The company significantly changed its plans subsequent to its filing, and after Staff and intervenors had filed their testimony. The company had alternatives available to it rather than merely introducing this new development in its rebuttal case. It could have sought to amend its filing, and to introduce an analysis supporting the reasonableness and timing of its decision to cancel the plant. For these reasons, this PFD recommends that the Commission adopt Staff's initial recommendation and defer a decision on recovery until the company's next rate case; in that filing, the company should present a detailed itemization of its costs and an explanation of the time frame of its decision making to show that it was reasonable at every point. In the meantime, consistent with the Commission's decision in Case No. U-16191 and Staff's recommendation in this case, the Clean Coal Plant costs should be excluded from rate base.

7. Accumulated Provision for Depreciation

Consumers and Staff agreed that the accumulated provision for depreciation should be $3,987,976,000 on a total company basis or $3,970,709,000 on a jurisdictional basis. Staff presented its calculations based on its use of updated September 30, 2011 balances for the beginning of the test year, as shown in Exhibit S-2, Schedules B-1 and B-3.[172] The company adopted Staff's calculation.[173] Of course, the parties are free to argue in exceptions to this PFD that additional adjustments are required based on capital expense adjustments recommended in this PFD.

[172] See Krause, 5 Tr 1078.
[173] See Consumers brief, page 37.

B. **Working Capital**

Consumers' initial filing presented its working capital calculation in Exhibit A-7, Schedule B-4, showing a total company working capital of $607,919,066 ($603,705,000 on a jurisdictional basis). Ms. Rolling testified that the company's working capital calculation used the balance sheet approach mandated by the Commission since Case No. U-7350. She started with the 2010 historical working capital, adjusted it to reflect March 2011 balances, which were further adjusted to reflect a change in accounts receivable financing Mr. Rao testified to, and to reflect changes to pension and OPEB balances based on Mr. Kops's projections.[174]

Staff's working capital calculation was presented by Ms. Bankapur. She testified that she also used the balance sheet working capital method required by the Commission. She testified that the $600,000 difference between Staff's working capital recommendation and the company's recommendation was due to Staff's removal of the PeopleCare account from the company's accounts receivable. She testified that the donations should not be included in working capital for ratemaking purposes because "working capital is a measure of investor funding of daily operating expenditures and a variety of nonplant investments that are necessary to sustain ongoing operations of the utility."[175] She cited the Commission's decision in Case No. U-15245.

In her rebuttal testimony, Ms. Rolling testified that in the company's calculation, the company's contribution to PeopleCare was reflected through a reduction in accounts receivable and an increase in uncollectible expense, essentially as "debt forgiveness".

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[174] See 3 Tr 172.
[175] See 5 Tr 1028.

She testified that Staff's adjustment essentially double-counts the impact of the program on the company's balance sheet.[176]

As indicated above in the discussion of Staff's use of September 30, 2011 actual plant balances as the starting point for projecting net plant, Ms. Rolling's rebuttal testimony also argues that to be consistent with Staff's use of the September 30, 2011 balances, the working capital projection should be updated. On this basis, she testified that updated working capital balance would be $170 million greater than the amount included in the company's original filing, or $771,980,000 on a jurisdictional basis. "If the other balances are updated, the Working Capital balance needs to also be updated so that it is determined on a more comparable basis."[177] She testified that the 13-month average balances were determined at September 30, 2011, which were then adjusted to reflect a change in accounts receivable financing and to reflect changes to pension and OPEB balances as was her original calculation.

Staff's brief indicates that Staff no longer recommends the $600,000 PeopleCare adjustment, but recommends use of the company's initial working capital calculation, without the adjustment. Staff argues that the company's updated working capital presentation does not provide a better estimate of working capital requirements for the projected test year.

This PFD recommends that the Commission use the company's working capital balance as originally filed. While Ms. Rolling testified that the working capital balance needed to be "determined on a more comparable basis," she did not testify what the

[176] See 3 Tr 195.
[177] See 3 Tr 188.

basis of comparability is that requires this. Note, too, Staff's approach to net plant was a means of adjusting projected capital expenses to a reasonable level, which is not intrinsically linked to working capital. Moreover, Ms. Rolling did not present her calculations in an exhibit, and there was not time in the schedule for Staff to audit the company's calculations. While the Commission has established the 13-month average balance sheet method for working capital, adjustments to the results are relatively common. The Commission has acknowledged as an advantage of the balance sheet method that it can be adjusted.[178] The Commission has also acknowledged that what is important is that the working capital allowance be representative of the test year.[179]

C. <u>Rate Base Summary</u>

The following chart is intended to reflect the total company rate base resulting from recommendations set forth in this section above. The capital adjustments are based on 50% of the disputed capital expenses as shown. Additional adjustments to the accumulated provision for depreciation, depreciation expense, and allowance for funds used during construction (AFUDC) may be appropriate as a result of these recommendations; the parties may address these adjustments in their exceptions and replies to exceptions.

[178] See December 22, 1988 order, Case Nos. U-8335, U-8812, and U-8854 ("[T]he computational nature of the method permits the Commission to make adjustments to elements of the computation and thereby revise the calculation within a final order.")

[179] See June 26, 1985 order, Case No. U-7895 ("The purpose of this proceeding is to establish rates based upon those circumstances which are likely to exist during a projected test period. Although the historical test period is important, its value lies in forecasting conditions reasonably expected to exist during the projected test period. When the facts and circumstances in the historical period are not representative of those anticipated in the test year, adjustments should be made.")

Staff Filed Rate Base (Exhibit S-2, Sched B1)[180]	$7,337,271,000
Weadock 7 and 8[181]	($1,142,500)
BTS/Data Center[182]	($3,131,000)
SG/AMI[183]	($26,639,000)
Working Capital Adjustment	$600,000
Revised Rate Base	$7,307,000,000

V.

RATE OF RETURN

The rate of return component of the revenue requirements determination is designed to meet the constitutional and statutory standards entitling the utility to a fair rate of return on its investment. The Commission in its past decisions and the witnesses testifying in this case recognize as controlling precedent, the U.S. Supreme Court cases *Bluefield Water Works Co v Public Service Comm of West Virginia*, 262 US 679; 42 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Comm v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944).

Consumers initially filed for an overall rate of return of 6.92% on an after-tax basis, but reduced its requested overall rate of return to 6.86% in its rebuttal presentation by updating its estimated cost of debt. The company bases its request on its expected actual capital structure for the year ending September 30, 2012, and a cost

180 See Exhibit S-2, Schedule B-1, columns e and f.
181 2012 proposed expenditures of $2,285,000 from Exhibit A-29, x 50%.
182 2012 proposed expenditures of $6,262,000, Exhibit A-16, column d, x 50%.
183 $53.3 million additional capital expenditure included by Staff, 5 Tr 1048, x 50%.

of equity of 10.7%. Staff recommends an overall rate of return of 6.55%, based on a cost of equity of 9.95%. The Attorney General recommends an overall rate of return between 5.31% with a cost of equity of 10%, based on a hypothetical capital structure modeled on Consumers' parent company, with alternative recommendations if the Commission rejects his preferred approach.

To determine the rate of return to use in setting rates, it is customary to start with the development of an appropriate capital structure, and then to evaluate the appropriate costs to assign each element of the capital structure. The appropriate capital structure is discussed in subsection A below, the cost of long-term debt is discussed in subsection B, and the cost of equity capital is discussed in subsection C. The overall rate of return recommendation is presented in subsection D.

A. Capital Structure

The capital structure used for ratemaking includes as its components long-term debt, preferred stock, and common equity capital, and in addition includes short-term debt and other items such as deferred taxes that reflect sources of financing available to the company. Only long-term debt, preferred stock, and common equity capital are considered part of the utility's "permanent" capital, and it is common for capital structures to be shown in exhibits on both a "permanent" basis and on a ratemaking basis.

Staff and the company agree to the capital structure that should be used for the projected test year. Mr. Rao testified to the company' s recommended capital structure, presented in Exhibit A-9, Schedule D1a, which is based on the 13-month average equity and debt balances for the year-ended December 31, 2010, adjusted for expected changes for the test year, including a net reduction in debt of $163 million and an increase in equity of $279 million. Ms. Bankapur testified that Staff also recommends use of these projected balances, as presented in Exhibit S-4, Schedule D1. The projected permanent capital structure reflects a slight increase in the percentage of equity from 49.40% to 51.38%.

Mr. Coppola recommended that the Commission use a capital structure modeled on the capital structure of the company's parent corporation, CMS Energy. CMS Energy's permanent capital structure, he testified, had a common equity ratio of 27.8% and a debt ratio of 72.2% as of December 31, 2010, in contrast to the company's capital structure, which is relatively balanced between debt and equity. Mr. Coppola testified that CMS has funded recent capital infusions into the utility using debt:

> CMS Energy has sold or shut down most of its diversified businesses over the past few years. At this time, approximately 95% of CMS's assets and revenues are from CECo. During 2010 and 2009, all of CMS's earnings came from its utility subsidiary. Using the capital structure of CMS Energy reflects the actual situation that investors in the public perceive regarding CECo.[184]

Citing his Exhibit AG-24, he testified that CMS Energy does not plan to raise any equity capital for the next five years.

Mr. Coppola testified that the high level of debt leverage at CMS Energy causes the cost of debt issued by Consumers to be higher than it would be if CMS Energy had a more balanced capital structure. He cites rating agency reports, presented in Exhibit AG-25, including a Fitch report that states in part:

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[184] See 4 Tr 728.

> CMS' credit quality is supported by the financial strength of Consumer Energy, which benefits from credit metrics that are above average for Fitch's 'BBB-' rating guidelines for integrated utilities . . . Fitch notes Consumers' stand-alone rating would be higher than 'BBB-', but the utility's credit profile continues to be constrained by that of its parent company.

He characterized the Consumers capital structure as a "pro-forma, fictitious, capital structure", that he estimates costs ratepayers $106 million per year, or about 55% of the company's filed revenue deficiency in this case. He testified regarding other state regulatory agencies that use the parent capital structure for setting utility rates, including New York, Idaho, and Alaska.

The capital structure he recommends is presented in Exhibit A-26, and includes a 30% common equity ratio, slightly above CMS Energy's common equity level as of September 30, 2011. He also recommended that the capital structure include an increase in the percentage of deferred taxes, from the 15.89% used by the company to its balance as of June 30, 2011, shown as 23.74% in Exhibit A-26. He further recommended that the Commission require the utility in future cases to include a projection of deferred taxes in its capital structure, contending that the utility's pattern of significant increases in rate base and regular rate case filings justifies the additional effort.

In his rebuttal to Mr. Coppola's recommendations, Mr. Rao cited recent Commission orders adopting a capital structure for Consumers as a stand-alone company and setting as a reasonable goal for the utility a capital structure that is roughly balanced between debt and equity.[185] He also testified that the CMS Energy

[185] See Rao, 3 Tr 545.

capital structure recommended by the Attorney General is a financial rather than ratemaking capital structure, and thus not appropriate for the utility's electric rate base.

In his brief, the Attorney General relies on the extensive testimony provided by Mr. Coppola. He also argues that Mr. Rao's rebuttal testimony relied only on prior Commission decisions and did not address the "illusory nature" of the capital structure it recommends[186]

In its brief, the company quotes from the Commission decisions cited by Mr. Rao, Case Nos. U-15645[187] and U-15986[188], and argues that the Attorney General has not provided any reason to justify a reversal of those decisions. In its reply brief, the company also addresses the adjustments Mr. Coppola made to the CMS Energy capital structure to derive the capital structure he recommends for ratemaking purposes in Exhibit AG-26, including adjustments to short-term debt, deferred federal income taxes and JDITC. Consumers argues these adjustments mix time periods and different accounting methodologies such that there is no basis to conclude that these adjustments are representative for the test year.[189]

This PFD recommends rejection of the capital structure proposed by the Attorney General. As Consumers argues, the Commission has rejected similar arguments in at least two recent decisions. Nonetheless, the Attorney General raises a legitimate concern, that the unbalanced highly-leveraged capital structure of utility's parent company is causing the utility's debt cost to be significantly higher than it otherwise would be due to the increased financial risk perceived by creditors. Mr. Coppola also

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[186] See Attorney General brief, pages 12-20.
[187] November 2, 2009 order, pages 16-18.
[188] May 17, 2010 order, page 10.
[189] See Consumers reply brief, pages 25-28.

explained that due to the debt level in CMS Energy's capital structure, an ROE of 10.7% for Consumers, all else equal, translates to a 17% return on equity for CMS Energy's shareholders.

As the Attorney General argues, Consumers made no effort to address this underlying concern in its rebuttal presentation. The Commission has in the past recognized that hypothetical capital structures may be used in ratemaking as appropriate.[190] The Commission has also indicated its acknowledgement of the Attorney General's concern. In its May 17, 2010 order in Case No. U-15986, in rejecting the hypothetical capital structure for Consumers' gas rates, the Commission stated:

> The Commission is cognizant of the Attorney General's argument regarding double leveraging by CMS Energy; however, *at this time* the Commission is not persuaded that the capital structure of the parent company is reasonable for Consumers.[191]

For these reasons, this PFD recommends that the Commission direct Consumers to present an analysis of the impact of CMS Energy's capital structure on the utility's overall cost of capital in its next rate case.

B. <u>Debt Cost</u>

Staff and the company are now in agreement on the appropriate cost rates to use for short-term and long-term debt. As the company confirms in its initial brief, Mr. Rao agreed to the use of Staff's updated debt cost rates in his rebuttal testimony, using 5.70% for long-term debt, and 3.52% for short-term debt.[192]

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[190] See, e.g., October 28, 1993 order, Case No. U-10150, pages 18-20.
[191] May 17, 2010 order, page 10 (emphasis added).
[192] See Bankapur, 5 Tr 1026-1027; Rao, 3 Tr 527.

As an alternative to his recommendation that the Commission rely on the CMS Energy capital structure as the basis for the cost of capital calculations, Mr. Coppola recommended that if the Commission retains the stand-alone utility capital structure, it should nonetheless reduce the long-term debt cost. He testified that, but for the debt level of CMS Energy, he believed Consumers would have a higher credit rating and thus a lower debt cost. Referring to Mr. Rao's Exhibit A-9, Schedule D5, page 10, he testified that the average bond spread difference Mr. Rao calculated in comparing Detroit Edison to Consumers is representative of the additional cost Consumers is paying for debt. He therefore recommends that the Commission reduce the debt cost for Consumers using a stand-alone capital structure by this .29% margin, with the resulting impact on the overall cost of capital and revenue deficiency shown in Exhibit AG-33.

For the reasons explained above in connection with the capital structure, this PFD recommends that the Commission reject this recommendation, consistent with its recently-expressed preference to use the company's projected capital structure and cost elements. Additionally, Mr. Coppola's recommended debt cost adjustment would broadly apply to all existing company debt, rather than recent or projected debt issuances. This record does not clarify over what time period Consumers as a stand-alone company could have benefitted from lower debt cost, or whether the 29 basis point spread would be applicable historically. Instead, as explained above, this PFD recommends that the Commission call for an analysis of the impact of the CMS Energy capital structure on the utility's cost of debt.

C. Equity Cost (Return on Equity)

Consumers estimated a return on equity range of 10.7% to 11%, and recommended that the company's ROE be set at 10.7%, the company's currently authorized rate of return. Staff estimated a range of reasonableness of 9.5% to 10.25%, and recommended the ROE be set at 9.95%. The Attorney General recommended a return on equity of 9.7%, based on use of the stand-alone capital structure.

As discussed below, each witness testifying as to the appropriate return on equity employed a variety of analyses, as is customary, resulting in a range of estimates of the cost of capital. The analysts make a final recommendation by reviewing the range of estimates produced by the various models, using their judgment and experience.

1. Consumers Energy

Mr. Rao testified to the results of his analysis for Consumers, and presented Exhibits A-9, A-33 and A-34. He selected a proxy group of companies meeting the following criteria: the companies are classified as electric utilities by Value Line Investment Survey (Value Line); they currently pay dividends; they have bonds rated at or above a minimum investment grade of Baa3 by Moody's Investor Services (Moody's) and BBB- by Standard & Poor's; they have 50% or more of their revenues from regulated electric operations; they have net plant greater than $5 billion; and they are not currently planning a merger.[193] The 21 proxy companies meeting this criteria are listed in Exhibit A-9, Schedule D5, page 1. He testified that although he did not include CMS Energy in the proxy group, he did perform CAPM and DCF analyses on CMS Energy, and also performed a comparison of Consumers to Detroit Edison.

[193] See 3 Tr 494.

The CAPM approach equates the cost of common equity to the sum of the risk-free interest rate and a risk-adjusted premium that is proportional to the non-diversifiable, or systematic, risk of the stock. The adjustment factor for determining systematic risk is known as the stock's beta (β), which is the ratio of the relative volatility of the stock to the volatility of the market as a whole. Mr. Rao's CAPM analysis is presented in Exhibit A-9, Schedule D5, page 3. His estimated risk-free rate of 4.95% was based on average of 30-year treasury yield estimates from Global Insight's U.S. Economic Outlook and Blue Chip Financial Forecasts.[194] His market risk premium of 6.72% was based on the spread of average large company total stock market returns over the average income return on long-term government bonds measured over the time period 1926 through 2010.[195] The betas of 0.72 for the proxy group and 0.75 for CMS Energy were reported by Value Line. As shown in Exhibit A-9, Schedule D5, page 3, the average estimated return on equity for the proxy group is 9.76%; the median return is 9.65%. For CMS Energy, the estimated return using the CAPM is 9.99%.

For his risk premium analysis, Mr. Rao compared the returns of electric utility common stock to the yield on utility bonds to estimate the risk premium. His analysis shows that electric utility common stocks have an average risk premium of 4.12% over the yields of A-rated utility bonds, as shown in Exhibit A-9, Schedule D5, page 4. He then estimated the ROE by adding this risk premium to the estimated bond yields of A-/A3-rated and BBB+/A3-rated utility bonds, which were derived from the forecast long-term Treasury bond yield plus the bond spread rates shown in Schedule D5, page 6. The results are presented in Exhibit A-9, Schedule D5, page 7, and show returns of

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[194] See 3 Tr 496.
[195] See 3 Tr 497; Exhibit A-9, Schedule D5, page 2.

10.27% for A-/A3 rated utilities, which he indicates is the proxy group average rating, and 10.42% for BBB+/A3 rated utilities, Consumers' rating.

The DCF approach equates the market price of the stock to the expected present value of future dividends and price appreciation. The theory is that investors purchasing stock at a given price evaluate the expected future income stream they associate with the stock, both present and anticipated earnings, including dividends and capital appreciation. Assuming that future income streams are discounted based on the perceived risk of the investment, the cost of common equity is estimated as the discount rate used to reduce future dividends and appreciation to present value.

Using what he characterized as the standard annual form of the DCF model, or the "dividend growth model", in which the required return equals the expected dividend yield plus the expected rate of growth of dividends, Mr. Rao estimated the dividend yield and growth rates for the proxy group and for CMS Energy. He determined the growth rates from an average of Value Line, Zacks and Yahoo! Finance estimates, excluding from his analysis any company with a negative growth rate; he determined current dividend yields using the latest annual dividend amount for each company divided by the 30-day average stock prices over the period February 17, 2011 to March 31, 2011, and the expected dividend yield at the end of the first year by multiplying the current dividend yield by one plus the growth rate. The results of this analysis for each company are shown on Exhibit A-9, Schedule D5, page 8, with a mean return of 10.24% and the median return 10.12% for the proxy companies, and a return of 10.93% for CMS Energy.

Mr. Rao performed what he labeled a Value Line Book Value method, using Value Line projections of earnings per share and book value per share to estimate rates of return for the proxy companies. He reported the results on page 9 of Exhibit A-9, Schedule D5, with the average result 10.5% and the median result 10.42%.

Mr. Rao also referred to Detroit Edison's then-current authorized ROE of 11%, and discussed reasons why he believes that Consumers is more risky than Detroit Edison. He noted that Detroit Edison was one of his proxy companies, and is subject to many of the same Michigan-specific risks as Consumers. Page 10 of Exhibit A-9, Schedule D5 shows his evaluation of the additional return he believes is required to reflect the differences in bond ratings between Consumers and Detroit Edison. He concludes that Consumers should be authorized to earn a return at least 29 basis points higher than Detroit Edison based on the bond spread differential.

Mr. Rao also discussed at length his opinion of how investors view the Michigan economy and the present regulatory environment, testifying that investors find the existing authorized return on equity for the company of 10.7% to be commensurate with the risk profile of the company, and lowering the return would be detrimental to the financial health of the company and to its ability to raise capital. His Exhibit A-9, Schedule D5, page 11 presents Michigan-specific statistics that he asserts summarize the relative disadvantage Michigan utilities face when competing for capital.[196]

He testified that measured by bond ratings, Consumers is riskier than the proxy group of companies he selected. He testified that although the Moody's bond ratings for the proxy group and Consumers are the same, the proxy group has an average

[196] See 3 Tr 515.

Standard & Poor's bond rating one notch above Consumers' Standard & Poor's rating. Using information on the yield differences for A- rated bonds and BBB+ rated bonds compared to Treasury yields, shown on page 6 of Exhibit A-9, Schedule 5, he argues that the difference in the cost of equity between companies with those bond ratings should be more than the 15 basis point differential observed in the bond yields.[197] Applying the CAPM to further estimate this difference, he derives a value of 30 basis points, which is included in the comparison chart on page 13 of Exhibit A-9, Schedule D5. He testified that this 30 basis point difference can be viewed as an adjustment for Michigan specific risks that are not present in the proxy group.[198]

Mr. Rao's rebuttal testimony, addressing Staff's and the Attorney General's analysis, is discussed below.

2. <u>Staff</u>

Mr. Megginson presented Staff's analysis of the cost of equity. He performed a DCF analysis, a CAPM analysis, and a risk premium analysis, and he also presented information on the authorized returns awarded other utilities. His results are presented in Exhibit S-4, Schedule D-5. For the first two analyses, DCF and CAPM, Mr. Megginson also selected a proxy group, using the following criteria: that each company have an SIC Code of 4931 ("electric and other services combined") or 4911 ("electric services"); that each company have net plant between $4 billion and $25 billion; that each company derive at least 55% of its revenues from regulated electric service; that each company currently be paying dividends; that each company have a bond rating

[197] See 3 Tr 513-514.
[198] See 3 Tr 516.

within 2 rating levels of Consumers in ether direction; and that each company not currently be involved in merger activities. The 15 companies thus selected are listed in his Exhibit S-4, Schedule D5, page 1.[199]

As inputs into his DCF model, Mr. Megginson used 3 months of price data from one of the same source as Mr. Rao (Yahoo! Finance), but from July 1, 2011 through September 1, 2011. He looked at quarterly dividends in applying both what he labeled the "current" model, which simply adds the average dividend yield to the expected growth rate, and the "constant" model, which adjusts the dividend yield by the semi-annually compounded growth rate. The growth rates were based on analysts' assessment of the five-year growth rates in earnings and book value, taken from the Institutional Brokers Estimate System (I/B/E/S), Zacks and Value Line. His results are reported on Exhibit S-4, Schedule D-5, page 7, and show an average expected return of 9.36% and a median return of 9.85% using the constant model recommended by Staff.[200]

For his CAPM analysis, Mr. Megginson used beta coefficients from Value Line, as shown on page 1 of his Exhibit S-4, Schedule D5. For the proxy group, the average beta is .72. He explained that beta values below 1 are considered less volatile and thus less risky than stocks with beta values above 1. For this market risk premium, Mr. Megginson reviewed market return data over the period 1958-2010 from the same source used by Mr. Rao. Comparing the market returns to the government bond returns for the same time period resulted in a market premium of 5.00% over the 52 year period. Mr. Megginson used a risk-free rate of 4.9%, using Value Line's long-term

[199] See 5 Tr 1095-1096.
[200] See 5 Tr 1096-1098.

Treasury bond yield estimate for 2012. The resulting CAPM estimated rates of return are shown on Exhibit S-4, Schedule D-5, page 8, with an average CAPM cost of equity of 8.52%.[201]

Mr. Megginson also presented a risk premium analysis. In this analysis, he compared the Electric Utility Realized Market Return Average from 1932 through 2010 to the A-rated Public Utility Bond Yield Average for the same time period, explaining that Moody's provided continuous data through 2002, but results from 2003 through 2010 were based on the Dow Jones Utility Average Total Return Index. The average electric market return of 10.78% over that time period compared to the 6.63% average A-rated composite utility bond yield over the same time period resulted in an historical spread of 4.15%. Adding the historical spread to the current A-rated and BBB-rated utility bond yields of 4.99% and 5.54% respectively results in estimated costs of equity of 9.14% and 9.69%, as shown on Exhibit S-4, Schedule D-5, page 9.

In page 10 of his Exhibit S-4, Schedule D5, Mr. Megginson also presents information regarding authorized rates of return for utilities nationally. He lists the five-year average ROE of 10.36% and the 2010 average ROE of 10.28% in his summary presentation on page 11 of Schedule D5.

Mr. Megginson's review of these results led him to conclude that the appropriate return on equity for Consumers would be within the range of 9.7% to 10.25%, and he recommended that the Commission use the value of 9.95% in determining the overall cost of capital for the company. He testified that this recommendation is appropriate because it takes into account the results of Staff's model analyses, as well as the

[201] See 5 Tr 1098-1100.

company's currently authorized rate of return, capital structure, sound credit rating, and reliable access to capital and other sources of financing. He testified that Staff's recommendation provides the Company with a reasonable return on equity commensurate with investments of comparable risk, while offering Consumers the opportunity to maintain or improve its credit rating and attract additional capital.

3. Attorney General

As explained above, the Attorney General formulated different recommendations depending on whether the Commission elects to use the Consumers or CMS Energy capital structure.

Mr. Coppola testified that he used three methods in determining the cost of equity, a DCF analysis, a CAPM analysis, and a risk premium analysis, and in addition he made an evaluation of the current circumstances in the capital markets and the risk profile of CMS energy. In developing his recommended 10% cost of equity capital recommendation for the CMS Energy-based capital structure, he looked at DCF, CAPM and risk-premium results specific for CMS Energy, as shown in column e of Exhibit AG-27.

In developing his 9.7% recommendation, he relied on an 11-company proxy group, taken from Mr. Rao's list of 21 companies, but further limited to companies with BBB ratings.[202] The results of his discounted cash flow analysis are summarized in Exhibit AG-28. He derived the current dividend using the same stock price information presented in Mr. Rao's Exhibit A-9, page 8. He also used the same growth rates, except

[202] See 4 Tr 741.

for two companies, Emeren and Entergy, which were excluded from Consumers' analysis due to negative growth forecasts; for those companies, he used the available positive growth forecasts. The average return on equity for the proxy group is 10.47%. He also testified that the results of this model are highly dependant on the judgments of securities analysts, and that some of the high growth rates reflected may be a result of an expected rebound in sales from a low point in recent years, rather than a long-term sustainable growth rate.

For his CAPM analysis, presented in Exhibit AG-29, he used a risk-free rate of 3.26%, which he testified is the actual 30-year Treasury rate as of October 2011.[203] He used the same historical market risk premium and beta values presented in Exhibit A-9, page 2. The average return for the proxy group in this analysis was 8.18%. He attributed the difference between his results and Mr. Rao's higher results both to his use of the actual 30-year Treasury rate as the risk-free rate, and to his elimination of companies from the proxy group that he does not believe are good comparables. He also testified to limitations on the use of the CAPM, indicating that it doesn't sufficiently take into consideration certain "company specific" factors investors look to in assessing the risk of a particular security.

His risk premium analysis is presented in Exhibit AG-30. He used the same 4.12% historical spread of electric utility[204] stocks over bonds, and also added the spreads of utility bonds for A-/A3 and BBB+/A3 ratings compared to A-rated bonds, which Mr. Rao used. He used the recent 30-year Treasury rate of 3.62% used in his

[203] See 4 Tr 745.
[204] Mr. Coppola refers to "gas utility" common stocks, but his analysis is modeled on Mr. Rao's analysis, which clearly used "electric utility" common stocks. See Exhibit A-9, page 4.

CAPM analysis, discussed above. The results show an estimated cost of equity of 8.94% for the A-/A3 rating, and 9.09% for a BBB+/A3 rating.

Mr. Coppola presented a summary of his recommendation in Exhibit AG-27. From the range of results shown, recommending that more weight be given to the DCF results, he presents a weighted return giving the DCF method 50% weighting, and the other two methods 25% weighting each, resulting in a return of 9.52% for the proxy group and 9.81% for CMS Energy. He further commented on the Value Line Book Value method used by Mr. Rao, testifying that this is not an academically sound approach typically used by the Commission, because forecasted earnings are very imprecise and generally skewed toward optimistic levels. Also, he disagreed with Mr. Rao's testimony that Consumers faces risks greater than the proxy group. He asserts that the company fails to recognize that it now has a lower risk profile than in prior years, citing the RDM and ability to self-implement rate increases. Additionally, he addressed Mr. Rao's comparison of Consumers to Detroit Edison, noting that the Commission had most recently set Detroit Edison's authorized return at 10.5%, and identifying reasons he believes Detroit Edison has certain risks that Consumers Energy does not.

4. <u>Rebuttal testimony</u>

Mr. Rao's rebuttal testimony primarily focused on Staff's analysis.[205] He testified that he has revised his recommended return on equity range for Consumers to 10.5% to 11%. He further testified that setting a rate of return below 10.5% would send a wrong message to investors and analysts as they consider investment decisions within the

[205] See 3 Tr 526-544, 546-549.

State, and would threaten Consumers' ability to maintain its existing credit ratings, particularly when the U.S. economy is in a fragile situation.

Regarding Staff's analysis, he testified that Staff's recommended ROE does not adequately compensate investors, asserting that standard quantitative techniques are providing results that do not adequately reflect the return that investors expect and require. Acknowledging that Mr. Megginson did take into account the company's currently-authorized rate of return as well as the returns authorized for other utilities nationally, he did not accept his conclusions. He presented revisions of Staff's overall cost of capital calculations using ROEs of 10.7% and 10.5% in his Exhibits A-60 and A-61.

He further addressed what he perceives as limitations in the rate relief available under 2008 PA 286, reviewed risk factors associated with the Michigan economy, emphasized that Consumers Energy competes for investors with Detroit Edison, and provided excerpts from analyst reports to support his views regarding investor expectations. His Exhibit A-62 shows Detroit Edison's higher debt ratings compared to Consumers. His Exhibits A-63 and A-64 present additional information on Michigan's economy in comparison to the U.S., and on poverty in Michigan.[206] He also testified that the equity market is currently "risk averse," thus investors tend to require higher returns even when interest rates are low or decreasing, and that it will remain this way for a period of time.

[206] Exhibit A-63 is also included in exhibit A-9, Schedule D5, page 11. Exhibit A-64 shows the distribution of poverty in Michigan.

Specifically addressing Mr. Coppola's testimony, he testified that Mr. Coppola used inappropriate criteria and recommended a return that is unreasonably low. He responded further to Mr. Coppola's comparison of Consumers and Detroit Edison, asserting that independent credit rating agencies view Consumers as more risky, and defended his use of the Value Line Book Value method as an indication of analysts' expectations.

5. Briefs

The briefs of the company, Staff, and the Attorney General largely rely on the testimony of their witnesses. The Municipal Coalition also addresses the ROE, arguing that a 10.7% ROE is excessive, endorsing the analysis of both the Staff and the Attorney General, and urging the Commission to adopt an ROE of 9.95%, with an overall ROE of 6.55%.

Staff argues that its ROE recommendation:

> [T]akes into account the Company's solid credit rating from the major credit rating agencies, Michigan's improved economy from its troubled conditions in 2008-2010 and the beneficial provisions afforded regulated utilities in 2008 PA 286. . . [as well as] the Company's practice of filing annual rate cases since the passage of act 286, which has the effect of lessening the cash flow volatility of the firm and promotes less business risk.[207]

Staff argues that its proposed ROE recommendation is based primarily on the results of its return on equity models incorporating the use of proxy group and that the proxy group average rating of A-/BBB+ is equivalent to Consumers.

[207] See Staff brief, page 28, citations omitted.

Staff addressed Mr. Rao's contentions that Staff's recommended ROE needs to be adjusted upward to compensate investors for "Michigan-specific" risk by citing to the Commission's November 4 order in Case No. U-16191, acknowledging that credit rating agencies in their ratings analysis take into account local and state-specific risk factors when determining a rating for the utility. Staff also cites what it characterizes as "risk-mitigating" factors of PA 286.[208] In its reply brief, Staff argues that the company does not recognize the substantial risk mitigation provisions factored into the 2008 PA 286 legislation, and argues that Staff has appropriately accounted for both the risks attributable to Michigan's economy and measures that mitigate those risks.

Staff also directly addresses Consumers' contention that its ROE must not be set below that of Detroit Edison's, arguing that many factors go into the choice of an appropriate return on equity, but that adopting Detroit Edison's ROE reflexively is not appropriate. Staff also argues that in setting Detroit Edison's ROE, the Commission took into account separate financial considerations, a separate capital structure, and credit rating considerations, as well as a separate service territory and other individual factors. Staff argues that the Commission rejected a similar argument made by Consumers Energy in Case No. U-16191.[209] In its reply brief, pages 9-10, Staff further argues that the company's reliance on Detroit Edison is an apples-to-oranges comparison, and ignores potential differences in uncollectibles, energy theft, and risky asset ownership such as the Fermi 2 Nuclear Plant that affect risk or the perception of risk.

Staff also addresses Consumers' contention that Staff's recommended ROE would send a negative message to investors, arguing that the Commission sends the

[208] See initial brief, pages 34-35. See also reply brief, pages 7-8.
[209] See Staff initial brief, pages 35-36.

appropriate message to investors by authorizing a just and reasonable ROE based on record evidence, and arguing that in a period of declining interest rates, an investor would expect an authorized ROE to follow those interest rates.[210] In its reply brief, Staff argues that its ROE recommendation is aligned with the company's decline in risk from its sale of risky non-utility assets, the decline in interest rates, and the beneficial provisions inherent in Act 286.[211]

Consumers' reply brief notes that almost $40 million of the difference between Staff's and the company's revenue deficiency is attributable to the difference in return on equity.[212] The company also cites Mr. Rasmussen's testimony that the company is planning investments that will benefit customers and generate benefits to Michigan's economy. Further, the company challenges Staff's characterization of the company's credit ratings as "solid", arguing that the company's credit ratings are below Detroit Edison's, and that the company's credit rating was last increased in May, 2010, prior to the Commission's November 4 order in Case No. U-16191. The company asserts that Staff gave too much weight to the results of its CAPM, DCF, and risk premium analyses, given Mr. Rao's testimony that these quantitative models do not fully reflect the returns investors expect given current economic and financial conditions. The company emphasizes that returns authorized by other state regulatory commissions are consistently above Staff's recommendation in this case, averaging 10.28% for 2010, and 10.30% for the first two quarters of 2011.

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[210] See Staff initial brief, pages 36-37.
[211] See Staff reply brief, pages 10-11.
[212] See Consumers reply brief, pages 11-30.

The company argues that “Michigan-specific” risk is not reflected in the results for the proxy group, citing Mr. Rao’s testimony that investors perceive Michigan investments have a higher risk than the national average, and that Consumers is riskier than the proxy group because it has a lower credit rating than the proxy group average. The company also challenges Staff’s assertion that Michigan utilities, in a post 2008 PA 286 regulatory environment, may have less risk than utilities in other jurisdictions despite Michigan’s economic overhang. Consumers argues this statement does not appear in the transcript page cited by Staff[213] and disagrees with the assertion, citing Mr. Rao’s testimony.[214]

The company also points to Staff’s brief at page 36, where the company contends that Staff argues that the ROE set for the company should not consider the ROE authorized for Detroit Edison, claiming this disregards investors’ views of Detroit Edison as an alternative investment. The company further argues that Mr. Rao was the only witness presenting evidence addressing how investors’ risk perceptions of Detroit Edison compare to risk perceptions of Consumers: “Record evidence presented by Mr. Rao supports, indeed requires, a conclusion the return on equity authorized for Detroit Edison is a relevant consideration in setting a return on equity for Consumers Energy”.[215]

The company also claims that Staff’s contention that declining interest rates support a reduction in the authorized rate of return is without record support, relying on

[213] See Staff initial brief, page 34.
[214] See, e.g., 3 Tr 507-508, 532-533.
[215] See Consumers reply brief at 22.

Mr. Rao's testimony that in a volatile market, the cost of equity capital tends to be higher.

In response to Mr. Coppola's analysis, however, the company focuses on his recommended capital structure, discussed above, and on his recommended cost of equity for CMS Energy. But while the company addresses briefly Mr. Coppola's critique of the Value Line Book Value estimation, it does not take issue with any other aspect of Mr. Coppola's analysis.

6. Discussion

Reviewing the different analyses presented by the witnesses, it has long been recognized that there is no precise mathematical formula to determine the appropriate return on equity. This PFD finds that Staff's analysis of the cost of equity is reasonable, and results in an appropriate recommended range of the cost of equity capital for Consumers. Staff's analysis is based on a reasonable selection of a proxy group, which is well-matched to the utility in terms of size and risk. Staff's analysis uses methods the Commission has followed in the past, and is respectful of the Commission's prior determinations regarding these methods, e.g. the use of historical risk premium data over the time period 1958 to the present.[216]

Consumers does not challenge Staff's analysis "mathematically", but argues that the mathematical analysis ignores important risks and investors' perceptions of those risks, including "Michigan-specific" risk, the comparison of Consumers to Detroit Edison,

[216] See November 4 order, Case No. U-16191, pages 27-28.

and a risk-averse capital market. This PFD finds that Staff has properly analyzed these risks and reflected them in its analysis.

Mr. Megginson's recommendation takes into account a reasonable assessment of Michigan's economic outlook:

> It's a mixed bag. Economists believe that Michigan's job growth outlook will be positive in 2012 but subdued. This year, Michigan's economy increased at the second fastest pace in the U.S., buoyed primarily by the Big 3's increased automotive output and employment gains. Despite those gains, Michigan's unemployment rate was 11.1% as of September 2011, one of the highest in the nation and above the national rate of 9.1%. In addition, in late October 2011, the Whirlpool Corporation headquartered in Benton Harbor, MI, announced its plans to cut approximately 5,000 jobs in the coming months, about 1,200 in salaried positions. Other major corporations and employers have laid off workers or announced layoffs in the past few months with the anticipation of an economic slowdown in 2012. Michigan's housing foreclosures have decreased from their peak in 2009 and housing prices are expected to appreciate slowly for the remainder of 2011 into 2012. This growth could be tempered if auto sales lose steam in 2012, Michigan's housing market stays depressed, and the economic incentives geared at luring new business to the state don't produce the economic stimulus as planned.[217]

Michigan-specific risks have not been shown on this record to be qualitatively different from risks other utilities face. Economy-related risks, for example, are one of degree. As the Commission recognized in its November 4 order in Case No. U-16191: "credit ratings . . . consider a multitude of financial and business risk factors including the effect of the local, state, and national economic conditions, utility service territory, regulatory environment, cash flow adequacy, liquidity, peer comparison, and competitive position, among many others."[218]

Turning next to Detroit Edison, Staff has not ignored Detroit Edison, which is one of Staff's proxy companies, but has reasonably considered Detroit Edison in its analysis.

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[217] See 5 Tr 1089-1090.
[218] See November 4 order, page 28.

Pegging the ROE for one of the State's largest utilities to the previously-established ROE for the other of the State's largest utilities would seem to perpetually lock in an ROE for both of them, to limit the Commission's ability to respond to new market information, and to preclude customers from benefitting from a decline in capital costs. There is no reason on this record to believe Consumers competes more with Detroit Edison for capital than with other utilities. Staff, for example, notes that Detroit Edison has nuclear power and other risks that an investor might view as distinct from Consumers.

Additionally, as the Attorney General argues, Consumers did not address Mr. Coppola's contention that Detroit Edison's bond rating is higher than Consumers' due to the high percentage of debt in the CMS Energy capital structure. Nor did it address Mr. Coppola's contention that CMS Energy does not intend to raise equity capital until after 2015. While this PFD does not recommend use of a hypothetical capital structure or debt-cost rate for Consumers, Mr. Coppola's analysis puts a context to the company's numerous assertions regarding investor views of Consumers and Detroit Edison. Nonetheless, the Commission articulated in the last rate case its desire to ensure stable capital for the company at a time when it was increasing its investment in utility plant:

> [T]he Commission also finds that an ROE of 10.7%, which is just above the high-end of the Staff's range of reasonableness, is consistent with the Commission's desire to ensure, to the extent possible, that Consumers continues to have reasonable access to capital.[219]

The Commission expressed a preference for setting a rate of return at the upper end of Staff's recommended ranges. Since that November 4 order was issued little over a year ago, and the company appears to be facing similar circumstances, this PFD concludes

[219] See November 4, order, page 28.

it is reasonable to consider those analogous circumstances, and to provide stability in approach, and therefore recommends that the Commission adopt an ROE for the company near the top of Staff's recommended range, 10.25%.

D. Overall Rate of Return (Summary)

There are no disputes among the parties regarding the other cost elements. This PFD recommends the following ratemaking capital structure and cost elements, resulting in an overall weighted cost of capital of 6.68%.

Capital Structure	Amount	Percent	Cost	Weighted Cost
Long-term debt	$4,134,000,000	39.39%	5.70%	2.25%
Preferred stock	$44,000,000	0.42%	4.46%	0.02%
Common equity	$4,415,000,000	42.07%	10.25%	4.31%
Short-term debt	$184,000,000	1.75%	3.52%	0.06%
Deferred taxes	$1,667,000,000	15.89%	0.00%	0.00%
JDITC:				
Long-term debt	$25,000,000	0.24%	5.70%	0.01%
Preferred stock	0	0.00%	4.46%	0.0%
Common equity	$25,000,000	0.24%	10.25%	0.02%
Total	$10,494,000,000	100%		6.68%

VI.

ADJUSTED NET OPERATING INCOME

A. Revenues/Sales Forecast

Mr. Warriner presented the company's sales forecast and revenue calculation.[220] He testified that based on current rates, the company projects jurisdictional revenue of $3,725,535,000, as shown in his Exhibit A-10. Mr. Warriner testified that the company's forecast reflects the company's current outlook, as follows:

> Improving economic conditions in the Michigan manufacturing sector, expectations for increasing electric service under the Company's economic development rate E-1, and consideration of average weather conditions are major factors in the company's expectation that test year electric deliveries will increase about 2.0% from 2010 actual results. The forecast also reflects expected impacts related to the Company's Energy Optimization plan.[221]

He further testified that his weather-normalized sales projections for the residential class were made using regression analyses to forecast customers and customer usage separately. Commercial class sales were forecast similarly, taking into consideration economic conditions by service area. Industrial sales projections were based on a mix of regression analysis and customer-specific information.

Mr. Pung testified that Staff accepts the company's projections.[222]

Mr. Coppola recommended that the Commission increase the projected sales for residential customers, as shown on his Exhibit AG-4.[223] He testified that while the company is projecting an increase in total sales, it is projecting a decrease in residential

[220] See 4 Tr 920-935.
[221] See 4 Tr 928.
[222] See 5 Tr 1122-1123.
[223] See 4 Tr 677-681; also see Exhibits AG-1 through AG-3.

sales of 1.1%, based on a projected loss of customers, continued conservation, and reduced economic activity. He testified that regression analysis is dependant on the inputs, and in his opinion, the results of the company's regression analysis are not reasonable. Looking at data for the first 8 months of 2011, he testified that both the number of customers and weather-normalized deliveries increased over the comparable time period in 2010. He also testified that the company declined to make its model available for review based on a claim that it was proprietary. Mr. Coppola testified that using the more recent information for the first 8 months of 2011 is superior to relying on the company's regression analysis. He extrapolated the .9% increase over the 8 months of 2011 compared to the first 8 months of 2010 to project an increase in sales over the test year of 296,076 kWh rather than the decline of 138,056 kWh forecast by the company, which he estimated to reduce the company's revenue deficiency by approximately $39.1 million.

Ms. Richards testified to her conclusion that the company's load growth forecast is aggressive, and her recommendation that the Commission forecast zero economic growth to ensure that the company does not overinvest in power supply resources.[224] She testified that it is a "very common practice" that load forecasts include a sensitivity analysis or use multiple cases of variables when preparing forecasts:

> By using the variables as a single set of inputs, CEC is relying on one set of variables or one set of assumptions of the future to determine one set of results. The results – which may represent one possible outcome – do not give us any idea of what is a likely or probably [sic] outcome in the Test Year. . . . In fact, the load forecast is a fundamental driver to resource planning and the resource decision-making process. Similar findings were pointed out in the Staff report on CEC's Electric Generation Alternatives Analysis in Case No. U-15996 (September 8, 2009, pp 12-

[224] See 6 Tr 1461-1463.

> 16). Therefore, this issue has clearly been brought to CEC's attention in the past and yet it continues to use a single point approach to forecasting load.[225]

She testified that the economic variables the company used to project Commercial and Industrial sales do not consider the possibility that the economy will remain stagnant during the test year and subsequent years, and that replacing the company's economic growth assumptions with the assumption that the economy will not grow results in 2.46% decrease in the Commercial forecast and a 14.73% decrease in the "Other Industrial" forecast and a 24.31% decrease in the GM/Delphi forecast by 2015.[226] Her "no growth" forecasts are presented in Exhibit NRD-6, and are approximately 5% below the company's test year projections for the Commercial and Industrial classes. Ms. Richards also testified to other concerns with the company's forecast, including its use of the median rather than mean of Cooling Degree Days in weather normalization, and an increasing trend in residuals, which indicates to her that the company's modeling omits a variable.[227]

In his rebuttal testimony, Mr. Warriner took issue with Mr. Coppola's recommendation, arguing that the August 2011 sales data Mr. Coppola relied on is inconsistent with more recent data. He testified that through October of 2011, actual residential sales are up only .1% over the comparable period a year earlier, and on a weather-normalized basis, declined 0.2%.[228] Mr. Warriner also took issue with Mr. Coppola's calculations of the revenue impacts of the Attorney General's sales forecast. He did not specifically address Ms. Richards's testimony.

[225] See 6 Tr 1462.
[226] See 6 Tr 1463.
[227] See Exhibit NRD-7, 6 Tr 1465, n3.
[228] See 4 Tr 939.

The Attorney General's brief argues that the dispute on this issue is whether recent sales and usage should be used in forecasting. The Attorney General characterizes the company as simply disagreeing that recent sales data can be used in the projections. The company responds that the Attorney General's assumption that residential sales will continue to grow at the same rate as the first 8 months of 2011 is not well-founded, given the sales results in September and October.

Consumers' initial brief also addresses Ms. Richards's analysis, disagreeing that the load forecast should be based on no economic growth. The company points out:

> An intentionally reduced load forecast necessarily results in the expectation of lower sales levels in that time frame. As fixed costs are spread over sales forecasts, higher rates must be allocated to satisfy the fixed cost recovery. NRDC/MEC's hypothesis that "CEC may collect revenues from ratepayers disproportionate to its need" . . . is backwards. Over-collection is inevitable if load forecasts are manipulated to project sales lower than expected.[229]

Neither MEC/NRDC's brief nor reply brief, however, addresses the load forecast to be used in the test year revenue projections for this proceeding.[230]

There is obviously some room for disagreement regarding the appropriate sales forecasts. Ms. Richards's recommendation that the company provide a sensitivity analysis with its forecasts is reasonable, but not useful in selecting projections based on this record. Therefore, since Mr. Warriner's rebuttal testimony indicates that current information supports his projections, since the Attorney General has not addressed this recent information, and since MEC/NRDC does not argue that the "no growth" forecasts

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[229] See Consumers brief, page 66.
[230] MEC/NRDC does rely on Ms. Richards's testimony, however, in discussing whether the company reasonably relied on its forecasts to support its Clean Coal Plant decision making.

should be used to set rates in this case, this PFD recommends that the Commission adopt the company's sales and revenue projections for the test year.

B. Fuel, Purchase, and Interchange Expense

Mr. Ronk testified to the company's projected fuel, purchase, and interchange power expense for the test year, presented in Exhibit A-8, of $2,007,195,000 on a total company basis.[231] Staff used the same projection.[232] No party challenged the projection, although as discussed below, MCAAA objects to resetting the PSCR base.

C. Operations and Maintenance Expenses

1. Fossil & Hydro Generation

Mr. Kehoe presented the company's proposed O&M expenses for its fossil and hydro generating units for the test year.[233] As shown in Exhibit A-28, Consumers is proposing expenditures totaling $176,366,000 for the year ending September 30, 2012, with the largest components labeled "base O&M" and "major maintenance", and smaller categories labeled "SCR operation excluding urea costs", "pulse jet fabric filter operation", and “HEPS & FAC".

He testified that the company's base O&M projection was calculated using a linear regression, which estimated an annual rate of increase of 2.25%. He testified that the company tracks its base O&M costs by labor and non-labor; the non-labor costs

[231] See 3 Tr 309.
[232] See Pung, 5 Tr 1123; Staff brief, page 54; Exhibit S-3, Schedule C-1.
[233] See 6 Tr 1308-1316.

include fuel for equipment and vehicles, material, tools, cleaning supplies, facilities, security, and road and grounds maintenance.

He testified that the company's major maintenance expense projection was based on the company's two planned turbine outages and other planned work at the several of the companies generating units as described in his testimony.[234] Major maintenance expenses are further broken into two categories, outage and non-outage. Proposed expenditures are based on unit-specific information provided by plant personnel, and analyses performed by the Fossil and Hydro Generation Division for each project, leading to a preliminary plan that prioritizes maintenance work and that is then reviewed by management before a schedule is created. He testified that Consumers has the oldest regulated electric generating fleet in the nation, and thus the units require more frequent inspections and routine maintenance than most others. He also testified that for the last two years, the company's non-fuel O&M cost per MWh ranked in the lowest quartile in the country.[235] Mr. Kehoe also explained that the company's major maintenance expenditures for 2010 were approximately $18 million below the company's forecast in Case No. U-16191 for the following four reasons:

> 1.) Three (3) scheduled outages were moved out of 2010 - two were moved into 2011 and one into 2014. Moving these outages reduced Major Maintenance spending by $14.5 million. 2.) The scope of two (2) outages was reduced after the unit was inspected and it was determined additional work was not necessary. Eliminating this work accounted for $3.3 million. 3.) Due to lower than expected dispatch and subsequent delay in the milestone scheduled outage, Zeeland's Major Maintenance spending was $1.8 million less than anticipated. 4.) The information required by the EPA for Hazardous Air Pollution (HAPs) Testing was not

[234] See 6 Tr 1308-1310.
[235] See 6 Tr 1314-1315.

> as detailed as originally anticipated. As a result, Consumers Energy spent $900,000 less than budgeted.[236]

He testified that the other categories of expenses, lines 3 to 5 on Exhibit A-28, are related to the company's Selective Catalytic Reduction (SCR) and Pulse Jet Fabric Filter operations for environmental compliance, and high-energy piping surveys and flow-accelerated corrosion testing (HEPS and FAC testing). Regarding the HEPS and FAC testing, he also testified that work planned for 2010 was deferred to 2011 and 2012:

> In response to an accident that occurred in 2006 at AEP's Kammer Unit 1, Consumers Energy is increasing its work in these areas, for the safety of our employees and to avoid extended unplanned outages. It is also important to understand HEPS and FAC testing can only be performed during an outage. Because Consumers Energy rescheduled several 2010 outages, less HEPS and FAC testing was completed. The 2010 outages that were not completed were moved into 2011 and 2012, resulting in increased HEPs and FAC spending in those years.[237]

The Attorney General and MEC/NRDC presented testimony addressing the base O&M expense projection.

Mr. Coppola also noted that the company's forecast expense level of base O&M expenses in Case No. U-16191 was above its actual expenses by over $18 million. He also testified that while the company is projecting an increase of 6.6% above 2010 levels for the test year, over the five-year period 2006 to 2011, the company's expenses rose at an average 2.9% level,[238] which he believes is a more realistic projection. He further testified that the company's base O&M expenses in 2011 were only 1.5% above its expenses in 2010. On these bases, he recommended that the Commission set the

[236] See 6 Tr 1315-1316.
[237] See 6 Tr 1308.
[238] See Exhibit AG-7.

amount of base expenses at the 2011 level of $126.8 million, a $6.5 million reduction in the company's projection.[239]

Ms. Richards testified that the company's projection methodology is flawed because it uses linear regression on only 3 data points, which she testified is an insufficiently large sample and the results are not statistically valid.[240] In addition, she testified that one of the data points, 2011, was only an estimate made before the year was finished. Looking at the data points, she identified a compound annual growth rate (CAGR) of 1.8%, but testified that Consumers is projecting a 5.2% increase over its reported base O&M expense for 2011. Using what she labeled simple trend analysis, she predicted future costs of $129,038,000 for the test year, or $4.3 million below the company's estimate.

Mr. Kehoe addressed these recommendations in his rebuttal testimony. Regarding Mr. Coppola's base O&M recommendations, he testified that Mr. Coppola did not identify any egregious or questionable projects or expenditures, and noted that Mr. Coppola acknowledged that the company's expenses have increased at a level of 2.9% a year over the last five years, which he testified is above the 2.25% base annual increase used in the company's projection.[241]

Addressing Ms. Richards's testimony, Mr. Kehoe defended the company's use of linear regression, asserting that Ms. Richards did not validate her claim that the company's use of only 3 data points in its regression analysis is flawed, or document

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[239] See 4 Tr 687-688.
[240] See 6 Tr 1472.
[241] See 6 Tr 1344-1345.

her alternative CAGR calculations. He testified that Consumers Energy calculated the CAGR to be 2.18%.

Staff, MEC/NRDC, and the Attorney General presented testimony regarding the major maintenance and other expenses in the fossil and hydro generation category. Mr. Coppola testified that the company's test year major maintenance forecast is 41% above its 2010 major maintenance expense level. He presented Exhibit AG-7 to show that although the company is proposing major maintenance work on 6 turbines in the test year, in 2010 it performed major maintenance on only 3 units. Citing the company's U-16191 major maintenance expense projections as another example of the company's overprojections, he recommended that the Commission use a three-year average of $29.4 million for the category, in lieu of the company's test year projection.[242]

Ms. Rusnak presented Staff's recommendation that all additional O&M expenses above the base O&M expense level be removed from the test year forecast for the company's "marginal" plants as discussed in section IV.A above. Her adjustment removed $11.5 million in major maintenance and HEPS & FAC expenses for the Whiting and Cobb plants, based on the information presented in Exhibit S-8.[243]

Ms. Richards likewise testified regarding the company's proposed major maintenance expenditures for the “seven classic” plants, consistent with her testimony as discussed in section IV.A above, recommending that the expense projections be rejected based on the company’s failure to reasonably analyze the alternatives.

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[242] See 4 Tr 688-689.
[243] See 5 Tr 1162-1164.

In his rebuttal testimony on the major maintenance and other expenses, consistent with his testimony discussed in section IV.A, Mr. Kehoe testified that the company is only seeking major maintenance expenses to operate the marginal plants or seven classics until they are mothballed. He testified that the plants will continue to produce competitively priced energy through 2014, with a small but significant benefit to customers, and continued operation will insure system reliability and stability, and allow the company to initiate a plan which minimizes the impact on all affected parties.

a. Base O&M

The Attorney General supports a reduction of $6.5 million in the base O&M expense projection, based on Mr. Coppola's testimony. In its initial brief, the Attorney General cites Mr. Coppola's testimony and addresses the company's rebuttal testimony by arguing that it is deeply flawed because it does not indicate how amounts authorized in prior rate cases were spent.

MEC/NRDC's briefs argue that the company's base O&M expenses should be reduced by $4.3 million, based on Ms. Richards's testimony. In response to Mr. Kehoe's rebuttal testimony that Ms. Richards did not document her calculations of the "CAGR", MEC/NRDC cites her Exhibit NRD-14. In response to his contention that her calculations were incorrect, MEC/NRDC argues that Mr. Kehoe misapplied the formula he relied on, using four years rather than three as the time period being measured.

In its briefs, Consumers relies on Mr. Kehoe's rebuttal testimony to explain why the company's requested expense projections should be adopted.[244] Regarding Ms. Richards's base O&M calculation, Consumers argues that MEC/NRDC has not

[244] See initial brief, pages 73-77; reply brief, pages 30-31, 42, 43.

established why Ms. Richards's calculation is more accurate than the company's regression analysis, and dismisses MEC/NRDC's brief arguments as "mere argument by . . . counsel."[245]

The difference between the company's projection and MEC/NRDC's recommendation for base O&M expenditures is $4.28 million. Both parties agree that it is reasonable to project an increase in base O&M expenditures based on the historical rates of increase; the dispute is how to measure historical rates of increase. The Attorney General argues that no increase should be granted, resulting in a reduction of $6.5 million, although Mr. Coppola also acknowledged that using the five-year historical rate of increase of 2.9% would be reasonable.

Both MEC/NRDC and the Attorney General identified a legitimate concern with the company's base O&M projection. Although Mr. Kehoe testified that the company projects a 2.25% increase in this category of expenses,[246] he did not reconcile this projected level of increase with the 5.2% increase forecast from 2011 to September 30, 2012.[247] Also, as Ms. Richards testified, it is questionable whether the company should be using linear regression techniques to project expenses based on three data points, one of which is itself an estimate. Ms. Richards noted that the CAGR from 2009 to 2011 is 1.8%.[248] Mr. Coppola noted that the average rate of increase over the last five years, 2006-2011, is 2.9%. While this PFD concludes that MEC/NRDC has reasonably

[245] See Consumers reply brief, page 43. Regarding the major maintenance and HEPS/FAC expenses for the plants to be mothballed in 2015, Consumers argues as it did regarding the capital expenditures for those plants that the proposed expenses are necessary to safely and reliably operate the plants.
[246] See 6 Tr 1307.
[247] See Coppola, 4 Tr 688.
[248] As shown in the parties' briefs, there is some debate about this calculation, but Ms. Richards's calculations are documented in Exhibit NRD-14, and are arithmetically verifiable. Mr. Kehoe's testimony that her calculations are erroneous is not persuasive for this reason.

estimated the historical rates of increase over the 2009-2011 time period, it appears more reasonable to use the longer-term rate of increase of 2.9% testified to by Mr. Coppola and supported by his Exhibit AG-7. The resulting projected expenditure for 2012 would be $130,427,000,[249] and using the 2011 projection for the first 3 months of the test year and the 2012 projection for the last nine months of the test year results in a projected expense level of $129,508,000, or an approximate reduction in the company's projection of $3.8 million.

b. Major maintenance and other expenses

In their briefs, MEC/NRDC, and Staff argue that the major maintenance and HEPS/FAC expense projections should be rejected for the plants Consumers plans to mothball. Consumers argues as it did regarding the capital expenditures for those plants that the proposed expenses are necessary to safely and reliably operate the plants, citing Mr. Kehoe's testimony discussed above.

Staff's brief addresses Mr. Kehoe's rebuttal testimony regarding these plants, and argues that regardless of whether the smaller plants are required to be retired or planned to be mothballed, the Commission should not approve amounts in rates that include recovery of O&M expenses above the base level for marginal plants that have operational uncertainty.[250] Consistent with its position on capital expenditures discussed above, Staff's reply brief indicates that the two Weadock units should also be considered "marginal" units in light of the company's decision to mothball these units in 2015, and therefore Staff recommends that the Commission exclude major

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[249] See Exhibit A-28, line 1, col (d): $126,751,000 x 1.029 = $130,427,000.
[250] See Staff brief, pages 38-39.

maintenance and HEPS & FAC expenses for these units for the test year. Citing its Exhibits S-7 and S-8, Staff calculates the additional adjustment as $2.6 million, including $458,000 for HEPS & FAC expenses for Weadock units 7 and 8, and $2.1 million for major maintenance expenses for the same units.

Staff's reply brief also emphasizes Mr. Kehoe's testimony regarding the company's deferral of capital expenditures for 2010, acknowledging that in Case No. U-16191, the Commission approved capital expenditures of $43.5 million but the company spent only $25.7 million. Staff argues that the company's flexibility in the past/ past deferrals undercuts its contention that it cannot safely and reliably operate the marginal units.[251]

The Attorney General argues based on Mr. Coppola's testimony that the expense projections for this category should be reduced by $6.8 million to the level of the three-year for the category.

For the reasons discussed in section IV.A above, this PFD recommends that the Commission adopt Staff's and MEC/NRDC's recommended adjustments to Consumers' proposed generation O&M expense projection to remove the major maintenance and HEPS & FAC expenses associated with the seven marginal plants scheduled to be mothballed in 2015. Staff's analysis reasonably considered the change in circumstances in recommending that Weadock expenses be added. Although Consumers asserts that some of these expenditures are required to safely operate the plants, the company has demonstrated flexibility in the timing of these and similar expenditures in recent years, and should be required to demonstrate that it actually intends to undertake these

[251] See Staff reply, pages 13-16.

maintenance measures and that the planned expenditures are reasonable, under the circumstances. The resulting adjustment totals $14.1 million. Because this adjustment is more specific than the adjustment proposed by Mr. Coppola, no further adjustment to this category of expenses is appropriate based on his analysis.

2. Electric Distribution

Mr. Anderson testified to the company's projected O&M expenses for the Electric Distribution Division. As shown in Exhibit A-12, the company is projecting total expenses of $246,497,000 for the test year, broken down into "electric distribution division" expenses of $166,961,000, "forestry" expenses of $53 million, and "LIEEF" expenses of $26.5 million.[252] For the division expenses, he testified that the company began with 2010 actual expenses, and added amounts to support a reliability improvement program that includes an expanded pole inspection program, a pole top maintenance program, and requirements associated with NERC's reliability standards now under development. He testified that the division's expenses are reasonable based on an analysis of FERC data showing that the company ranks in the second quartile in O&M cost per customer. He also testified that the division expense category is further subdivided into "electric energy operations", "electric energy delivery" and "electric customer operations", which he further described.

For forestry expenses, he testified the company is proposing $53 million for line clearing in the test year, which he said equates to 7,900 miles or 25% of the high-voltage distribution system and 12.5% of the primary low-voltage distribution system annually. To explain customer benefits associated with the operation, he testified that

[252] See 4 Tr 847-861.

trees caused an average of 22% of customer interruptions from 2006 to 2010, and that although the recent years show improvement, the long-term trend shows a slight increase in outages. He testified that the company has identified an optimal level of clearing of 14% or 7 years for the LVD system, and 25% per year for the HVD system, but is proposing the reduced LVD clearing amount to lessen the cost impact. He used the DARE model, discussed above in connection with the company's proposed capital expenditures, to predict an 11 minute reduction in SAIDI outage minutes based on continuing the program at the current level of funding. He testified that over the last 10 years, the company has averaged a 7% clearing percentage, or a 14-year clearing cycle, while nationally utilities average a 4-year clearing cycle, while Michigan utilities use cycles between 4 and 7 years.

Regarding LIEEF projections, Mr. Anderson testified that the company projected expenses of $26.5 million, citing the Commission's decisions in Case Nos. U-14347, U-15245, U-115645 and U-16191.

Mr. Reasoner testified to Staff's recommendations. He testified that Staff reviewed the company's historical expenditures from 2002-2010, and presented a chart showing the levels. He further testified that in Case No. U-16191, the Commission approved a forestry expense level of $40.5 million for the test year ending June 2011, which represented a significant increase. He testified that Staff did not find evidence that the most recent 2011 increase in funding had been inadequate to increase distribution system reliability, and recommended that the Commission retain the same levels until they provide evidence over time of the usefulness of increased spending. Staff's recommendation is to use the 2011 level, adjusted for inflation at the rate of

1.73%, resulting in a test year expense level of $41.2 million. He testified this amount is 25% above the company's five-year average spending in this category.

Mr. Coppola also testified regarding the electric distribution category of expense, focusing on the forestry and reliability improvement program projections.[253]

Regarding forestry, Mr. Coppola testified that the company's proposed test year spending is 53% above its 2010 level. He reviewed Mr. Anderson's projections, including his use of the DARE model. He testified that the 50% confidence level identified by the company associated with the DARE projections is too low to rely on in spending tens of millions of dollars. Also, he testified that the projected 1.5% per year improvement in the System Average Interruption Duration Index (SAIDI) from 2012 to 2020 does not seem worth the additional cost. Reviewing historical spending and SAIDI measurements, he concluded: "It is obvious that the large ramp up in dollars is having only marginal improvements in the SAIDI."[254] Additionally, he questioned the company's commitment to increased spending, reviewing the company's spending history over the period 2001 to 2010.[255] He recommended that the Commission use the three-year average over the period 2009 to 2011 for the test year, resulting in a test year expense of $42 million.

Regarding the reliability improvement projects Mr. Anderson identified as additional expenditures not reflected in the 2010 base electric distribution expense on line 1 of Exhibit A-12, Mr. Coppola testified that the company's plan to add additional pole top maintenance results in expenditures of $8.7 million projected for the test year,

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[253] See 4 Tr 682-687.
[254] See 4 Tr 684.
[255] See chart, 4 Tr 685.

while in 2011 the company expected to spend $2.3 million on pole top maintenance, and spent $1.7 million in 2010. He testified that the company requested and received $16.3 million for reliability improvements in Case No. U-16191, but spent only $8.6 million. He recommended that the Commission allow the same amount spent for pole top maintenance in 2011, rounded up to $2.5 million.

In rebuttal, Mr. Anderson testified in response to Mr. Reasoner and Mr. Coppola.[256] He testified that Staff and the Attorney General rely on historical levels of forestry expenses, which fails to recognize that that historical level of expense did not adequately address the overall system tree conditions. He testified that Staff's recommendation results in a 10% or 10-year clearing schedule, which is twice as long as the industry average. He testified that it is not reasonable to expect the company's overall system reliability to improve without increasing the program that has the greatest impact on reliability.

Addressing the company's pole top maintenance plans, he disputed Mr. Coppola's assertion that the company had not explained what the company's projected increase in reliability expense consists of. He cited his direct testimony, and further asserted that the current limited level of spending will generate approximately the same results and will not reduce equipment failures, which are the second leading cause of outages.[257]

Addressing its forestry expense projection, Consumers' brief reviews Mr. Anderson's direct and rebuttal testimony, arguing that Mr. Anderson's testimony

[256] See 4 Tr 874-878; 884-886.
[257] See 4 Tr 886-887.

extensively detailed the inadequacies of historical spending relative to tree growth, and arguing that the Commission should fund the forestry program at an effective 8-year clearing cycle for the low voltage distribution system. The company's brief also notes a slight discrepancy between the level of forestry expenses included in Staff's revenue requirements calculation and in Mr. Reasoner's testimony.[258] In its reply brief, the company argues that Staff's "wait and see" approach to forestry spending will result in continued deterioration of the system and worsened reliability.[259]

Consumers also notes that the LIEEF program has been terminated, but that legislation passed in December 2011 created the Vulnerable Household Warmth Fund and authorized funding at the previously approved LIEEF amounts for Consumers.

Staff's brief reviews Mr. Reasoner's testimony and addresses Mr. Anderson's rebuttal testimony by arguing that Staff's focus and responsibility is not on determining the appropriate line clearing frequency for the company, but recommending funding in light of the company's recently-approved 25% increase in funding for these expenses. Staff argues that only after the company demonstrates benefits to the customers from that level of increase, should the Commission authorize a further significant increase. Staff's brief also addresses a $190,000 discrepancy in its recommendation between Mr. Reasoner's testimony and Mr. Welke's exhibit, indicating that Staff is comfortable using the larger of the two expense amounts.[260]

In his brief, the Attorney General relies on Mr. Coppola's testimony, also arguing in response to Mr. Anderson's rebuttal testimony that the company has not established

[258] See Consumers brief, page 70 at n13.
[259] See Consumers initial brief, pages 67-73; reply brief, pages 37-38, 41-42.
[260] See Staff brief, pages 50-53.

why historical expenditures did not allow the company to keep up with normal deterioration.[261]

This PFD recommends that the Commission adopt Staff's proposed O&M expense levels for this category, as clarified in Staff's reply brief. As explained above in discussing Staff's adjustment to the company's proposed capital expenditures for this category, Staff's recommendation that the Commission wait to evaluate the results of the significant increase in funding granted in the last rate case is reasonable. The company has not been able to evaluate that spending level in its presentation in this case, because it filed its rate case in the middle of 2011. In authorizing a significant increase in forestry O&M in Case No. U-16191, the Commission cited Consumers' argument that: "This level of funding is necessary to address the number one cause of outages on Consumers Energy's system: trees."[262] The logical inference is that the company represented to the Commission in that case that the amount of funding it was requesting was appropriate to address the number one cause of outages on the company's system.

Regarding the company's pole top maintenance program and projected O&M expenditures, only the Attorney General challenged those expenditures, and this PFD finds the company's projected level of spending adequately supported by Mr. Anderson's testimony. Unlike the forestry program discussed above, and the capital expenditures discussed in section IV above, the company did not request a significant increase in expenses for this category in its last rate case. Also, the company is only seeking a $9 million or 5.6% increase in the total electric division expenses from the

[261] See Attorney General brief, pages 27-31.
[262] See November 4 order, page 33.

2011 level. Mr. Anderson testified the additional amount would be spend on pole top inspection and maintenance as well as requirements associated with expected new NERC reliability standards, which Mr. Anderson characterized as “dramatic changes”.[263] Based on this testimony, this PFD does not recommend singling out the “pole top maintenance” expenditures for reduction.

3. Business Technology Solutions

Ms. Roth (adopting testimony filed by Ms. Beers) testified to the company's projected $32.8 million in O&M expenses for the Business Technology Solutions department, as shown in Exhibit A-15. These costs include the internal and external labor costs associated with operating and maintaining the company's business software systems and computing infrastructure. Ms. Roth testified to the reason for the 9% increase in this category of expenses from 2010 to 2011, and explained the company's projection for 2012 is only .2% above 2011 levels, reflecting productivity improvements since 2009 she attributes to the SAP implementation.

Mr. Coppola first focused on the company's 2008 implementation of the SAP system, with an estimated final cost of $176 million. Mr. Coppola testified that in discovery he asked for the company's initial forecast and the final report of cost savings and other benefits associated with its SAP implementation. Objecting to the quality of the response, provided in Exhibit AG-9, he testified that the company has not provided hard evidence of cost savings from the SAP system. He estimates the current cost to customers of that system at $29 million, as shown in Exhibit AG-8, which he acknowledges is similar to what he presented in Case No. U-16191. In the absence of

[263] See 4 Tr 848-849.

quantified savings, he recommended that the Commission impute cost savings of 50% of the annual estimated cost of the SAP system in setting O&M expense levels for the test year, or a reduction of $14.5 million.[264]

Mr. Welke testified that Staff's projection started with actual expenses for the year ended June 30, 2011, escalated through the projected test year using inflation factors. He testified that projecting the BTS and corporate services categories of expenses using inflation estimates has been the Commission's long-standing practice, and that use of other methods can lead to material overprojections, citing Exhibit S-3, Schedule C5.1 to show that the company overprojected O&M expense in last rate case by $60 million.[265]

In rebuttal, Ms. Roth testified in response to Staff's recommendation that if expenses for the period ending September 30, 2011, are used as the starting point in Mr. Welke's analysis, the result would be $499,000 higher, as shown in Exhibit A-66.[266] Since this projection is based on more current information, she testified, it should be used in lieu of Staff's recommended expense level.

In response to Mr. Coppola's recommendations, she testified that the Commission has found the company's SAP expenditures reasonable, and the Attorney General's proposed reduction would have significant adverse effects on the BTS department and the company. She addressed Exhibit AG-9, and testified that operational efficiencies that may have been attributable to SAP have been reflected in

[264] See 4 Tr 689-692.
[265] See 5 Tr 1200-1201.
[266] See 3 Tr 575.

operating plans since 2006, making it difficult or impossible to comprehensively analyze the performance of each department to evaluate the benefits of SAP.

In its briefs, Consumers relies on Ms. Roth's rebuttal testimony to address Staff's and the Attorney General's proposed reductions in the expense projections for the BTS programs.[267] The company did not modify its expense projection based on Ms. Roth's Exhibit A-66.

Staff argues that its methodology follows the Commission's long-standing policy, and avoids the overprojections inherent in the company's method.[268] Staff also does not directly address Exhibit A-66.

The Attorney General's brief cites Mr. Coppola's testimony and addresses Ms. Roth's rebuttal testimony by arguing that her statement regarding the company's inability to meet contractual obligations without the additional funding was not supported by evidence.[269]

This PFD recommends that the Commission accept Staff's adjustment to the BTS category of expenses. Although Ms. Roth presented updated information in her Exhibit A-66, the company's updated expenses through September 30, 2011, have not been audited.[270] This PFD recommends rejection of Mr. Coppola's recommendations, because Ms. Roth's testimony is persuasive that an exact measurement of savings from the SAP implementation is difficult. In Case No. U-16191, the Commission encouraged the company to identify cost savings and efficiencies achieved through implementation

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[267] See initial brief, pages 85-88; reply brief at 31-32, 42-43.
[268] See Staff brief, pages 39-41.
[269] See Attorney General brief, pages 34-35.
[270] Also, Exhibit A-66 appears to use more than one year's worth of inflation to escalate expenses for the 12-months immediately preceding the test year.

of the system, but did not require a conclusive demonstration. Using Staff's approach of starting with actual expenditures, efficiencies from the system upgrades will be reflected in the company's expense levels over time. The record does not support removing all SAP expenditures from the company's rate base.

4. Corporate Services

Mr. Jones testified to the company's projections for the corporate services division, as well as for injuries and damages and uncollectible expenses as summarized on Exhibit A-22. Exhibit A-25 contains the projections for the corporate services category, which includes the O&M costs associated with the administrative functions of the company, including human resources, internal control and compliance, legal, corporate risk management, and the offices of the corporate secretary and the controller.[271] He testified to normalizing adjustments made to the historical expense levels, as well as the exclusion of items the Commission has indicated are not recoverable. He testified that the projections for the test year are based on 2010 ongoing expenses for each department, with inflation factors for labor and non-labor, with adjustments for operational efficiencies and specific line items as appropriate. He testified the company is projecting a $1.7 million or 6% increase in the test year over 2010 normalized expenses, including inflation rates of 2.5% for 2011 and 1.8% for 2012, and adjustments for audit and trustee fees, and credit card fees for the recurring card payment program. He also testified to operational efficiencies reflected in the projection, and explained how common corporate service costs are allocated between electric and gas operations of the company. As further support for the company's

[271] See 4 Tr 952-960.

projection, he testified that the company's administrative and general costs, excluding pensions and other benefits, have been ranked third lowest out of 61 companies with over half-a-million customers.

As explained above, Staff projected O&M expenses for the corporate services category using inflation factors, for the reasons explained by Mr. Welke.[272]

Mr. Coppola testified that the company's proposed test year expense is a 6.4% increase over 2010 levels, based on inflation adjustments and wage increases forecast for 2011 and 2012. He testified that at a time when customers are facing escalating utility costs, it is inappropriate for the Commission to accept wage increases for utility employees at the corporate level, many of which are in the senior management ranks. For this reason, he recommended that the Commission hold the utility to 2010 expense levels for the test year.[273]

In his rebuttal testimony, Mr. Jones took issue with Staff's calculation, contending that Staff did not take into consideration normalizations for unusual or one-time items not expected to continue, and contending that Staff's use of actual expenses through June 30, 2011, plus inflation is inconsistent with Mr. Krause's use of actual expenses through September 30, 2011.[274] Mr. Jones further testified that the calculations in his exhibit were prepared on a consistent basis with the calculations ordered by the Commission in Case No. U-16191.

Mr. Rasmussen presented rebuttal to Mr. Coppola's testimony, indicating that the wage increases Mr. Coppola objected to reflect anticipated increases in salaries for the

[272] See 5 Tr 1200-1201.
[273] See 4 Tr 693.
[274] See 4 Tr 975-976.

labor market for 2011 and 2012.[275] He testified that if the company does not maintain salaries at a competitive level, it risks losing employees to other companies.

In its briefs, Consumers relies on Mr. Jones's rebuttal testimony regarding Staff's proposed adjustments, and on Mr. Rasmussen's testimony regarding Mr. Coppola's proposed adjustments.[276]

Staff's brief argues that it chose the year ending June 30, 2011, as the starting point for its expense projection because it was both the end of the company's last projected test year in Case No. U-16191 and the most current data available. In response to Mr. Jones rebuttal testimony that Staff's approach is unreliable, Staff argues that its use of the most up-to-date information available at the time of its preparation has been shown to be more reliable than the company's projections, citing Exhibit S-3, schedule C5.1 to show that the company overprojected O&M expenses in its last rate case by over $60 million. Staff also argues that Ms. Roth agreed with Staff's general approach at 3 Tr 575. In support of its methodology, Staff also cites the Commission's October 20, 2011 order in Detroit Edison's rate case, Case No. U-16472.[277]

In his brief, the Attorney General cites Mr. Coppola's testimony and recommendations.[278]

This PFD recommends that the Commission accept Staff's adjustment to the company's projected test year expense for this category. While Mr. Jones helpfully

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[275] See 3 Tr 112.
[276] See initial brief, pages 78-80, reply brief, pages 30-31, 43.
[277] See Staff brief at pages 39-41.
[278] See Attorney General brief, pages 35-36.

identified normalizing adjustments in his Exhibit A-25, it is not clear why his projections from the 2010 historical data required continuing normalizations. Note that the adjustments Mr. Jones identified in Exhibit A-25 reduced the company's actual expenses for 2010 and its projections for 2011 and 2012. The company has not explained how Staff's lower expense projection for this category would fail to take into account those reductions. And, Staff's approach was based on more recent information regarding 2011 expenditures.

5. Uncollectibles Expense

For uncollectible account expenses, Mr. Jones testified that the company's projections, shown in Exhibit A-23, have two components, the write-off of accounts receivable deemed uncollectible, and changes in the uncollectible reserve account.[279] He testified that the majority of the receivables are for customer energy use, but also include non-energy receivables such as damage claims, rent, and theft.

Mr. Jones explained the company's test year uncollectibles projection of $32.3 million is the sum of the three-year average uncollectible expense of $19.8 million, plus a LIHEAP adjustment based on anticipated reductions in federal State Emergency Relief (SER) and/or Home Heating Credit (HHC) assistance.

Mr. Welke testified that Staff recommends two adjustments to the company's projections. First, Staff rejects the company's inclusion of a LIHEAP adjustment on the basis that LIHEAP relates to the company's gas business, rather than its electric operations. He testified that asked for an analysis of the impact of LIHEAP on electric

[279] See 4 Tr 960-963.

uncollectibles, the company merely cited "potential for further growth in the uncollectible expense . . . due to the decrease in [customer] discretionary income."[280] Since the company acknowledged it did not have a study estimating a ratio between the proposed dollar reduction in LIHEAP funding and an increase in uncollectible expense, Staff recommends that the Commission reject the company's $12.9 million projected increase. Second, Staff removed expenses related to the PeopleCare program from the company's projected expense to avoid placing ratepayers in the position of becoming involuntary contributors to charity.[281]

For uncollectible accounts expense, Mr. Coppola focused on the company's use of a three-year average. He testified that the company's approach is too simplistic, and that a better approach would be to develop a ratio of uncollectible write-offs to revenues for each of the three years; the average could then be applied to forecast revenues to determine the test year amount, as shown in his Exhibit AG-14. He therefore recommended an uncollectible expense of $18.8 million for the test year. He also recommended rejection of the company's LIHEAP adjustment to take into account expected reductions in federal LIHEAP spending, because the amount of potential reduction is unknown.[282]

In his rebuttal testimony, Mr. Jones addressed the company's LIHEAP adjustment, taking issue with Staff's assertion that reductions in LIHEAP funding would largely affect gas rates rather than electric.[283] He testified that the enabling act authorizes grants "to assist low-income households, particularly those with the lowest

[280] See 5 Tr 1203.
[281] See 5 Tr 1201 -1203.
[282] See 4 Tr 699-701.
[283] See 4 Tr 977-980.

incomes, that pay a high proportion of household income for home energy, primarily in meeting their immediate home energy needs." He testified that electric heating bills are eligible for HHC funding, although natural gas is the largest heating fuel and would swallow up a significant share of HHC dollars, and are eligible for the emergency SER funding. He testified that a reduction in LIHEAP funding would impact the electric uncollectible expense. He also presented the company's uncollectible expense for the first eleven months of 2011, and projection for December 2011, arguing that the current estimate for 2011 of $26.6 million is significantly above Staff's projection for 2012, without considering LIHEAP funding cuts.

In its initial brief, Consumers relies on Mr. Jones's rebuttal testimony regarding Staff's and the Attorney General's proposed adjustments to the company's uncollectible expense, including the LIHEAP adjustment, and also cites Mr. Rasmussen's testimony at 3 Tr 111 regarding the PeopleCare contributions.[284]

Staff's brief addresses Mr. Jones's rebuttal testimony regarding the company's LIHEAP adjustment and the PeopleCare program. See Staff brief at pages 41-43. Staff cites the American Gas Association paper presented by Mr. Jones and quoted by Mr. Welke in his testimony as stating: "[t]his critical program provides federal funding to help natural gas customers who struggle with home heating and cooling bills during times of extreme weather." Staff further argues that the company provided no support for its assertion that a reduction in discretionary income would have a direct impact on a customer's decision to pay their electricity bill. And Staff cites the Commission's recent decision in Detroit Edison's case, rejecting a similar argument made by Detroit Edison.

[284] See Consumers initial brief, pages 80-83; reply brief, pages 32-33.

Staff also addressed Mr. Rasmussen's rebuttal testimony regarding the PeopleCare program, arguing that Mr. Rasmussen's explanation of the program makes it still equivalent to charitable contributions, and urges that the expenses be removed from the company's expense projections.

In his initial brief, the Attorney General relies on Mr. Coppola's testimony.[285]

This PFD recommends that the Commission accept Staff's adjustments. Regarding LIEEF funding, the company made no effort to identify the percent of such funds historically used for electric bills, and did not justify the additional uncollectible expense projection associated with the loss of LIEEF funding presented on page 2 of Exhibit A-23. Treating the loss of LIEEF funds as a reduction in discretionary income generally, as Mr. Jones testified, such a reduction in income would ordinarily result in a reduction in consumption of utility services, a reduction in other purchases, and non-payment of other bills, not only utility bills. Likewise, this PFD finds that Staff reasonably excluded the PeopleCare amounts from recoverable expenses.

6. Injuries and Damages

Mr. Jones presented the company's $5 million forecast of electric injuries and damages for the test year, as shown in Exhibit A-24.[286] For property and liability damages, he used a five-year average for the period 2006-2010, increased by inflation. For internal legal costs charged to injuries and damages, and for workers' compensation costs, he used 2010 levels adjusted for inflation to the test year.

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[285] See Attorney General brief, pages 41-43.
[286] See 4 Tr 963-964.

Mr. Welke testified to Staff's recommended $1.1 million reduction to the company's injuries and damages projection. He testified Staff recommends that the total injuries and damages forecast be based on a five-year average. He indicated that the company had also used a five-year average, but only for a portion of the "injuries and damages" (925) account.

Mr. Jones addressed Staff's recommendation in his rebuttal testimony, asserting that the company's calculations followed established Commission methodology. He testified that use of recent historical expense plus inflation is appropriate for the less volatile categories of workers' compensation and internal legal costs, which he testified are easier to predict.

In its initial brief, Consumers relies on Mr. Jones's rebuttal testimony regarding Staff's proposed adjustments to the company's expense projections.[287]

Staff's brief takes issue with Mr. Jones's testimony that only a portion of the company's "injuries and damages" account (925) should be subject to a five-year averaging, suggesting that the company cannot rely on the account for reporting purposes and claim it is incorrect for ratemaking purposes.[288]

This PFD finds that Staff's five-year average appears to be consistent with the Commission-approved approach to forecasting injuries and damages expenses.[289] The company has not cited support for its alternative treatment of workers' compensation and internal legal expenses associated with injuries and damage claims. Note that the company also has continued to use inflation factors to project this category of expense,

[287] See Consumers initial brief, pages 83-84; reply brief, pages 33-34.
[288] See Staff brief, page 44.
[289] See Case No. U-16191, page 38.

although the Commission clearly stated in its November 4 order that inflation is not an appropriate consideration in developing injuries and damages amounts.[290]

7. Pensions & Benefits

Mr. Kops presented the company's expense projections for employee benefits and pension expense, as shown in his Exhibit A-32. Mr. Kops explained the employee retirement and insurance benefits, including changes the company has made to control costs.

Mr. Coppola testified that the company's Other Post-Employment Benefits Plan is significantly underfunded, causing higher OPEB plan costs. He testified that a better funded plan given the current level of benefit obligations would reduce expenses charged to O&M and capital items. His Exhibit AG-11 compares the cash contributions that company has made to the plan from 2005 to 2010 with the amount the company has collected in rates during the same period, with supporting information in Exhibits AG-12 and AG-13. He testified that the company collected approximately 23% more than it used to fund the plan. Also computing the estimated plan returns forfeited as a result of the underfunding, $6.9 million over six years as shown in Exhibit AG-11, he recommended that the Commission deduct this foregone interest cost from the company's O&M expense and capital expense projections, $4.2 million from O&M expense and $2.7 million from capital.[291]

Mr. Vogel testified in rebuttal to Mr. Coppola's testimony.[292] He testified that Mr. Coppola's estimated amount "included in rates", included both OPEB expense and

[290] See November 2, 2009 order, Case No. U-15645, page 38.
[291] See 4 Tr 697-699.
[292] See 3 Tr 630-633.

capitalized OPEB costs. He explained that the company's historical understanding was that funding requirements were limited to the expenses included in rates, with capitalized OPEB amounts funded in the future based on recovery through depreciation. He testified that the company placed into the OPEB trust all OPEB amounts included in rates as O&M expense. He further testified that Mr. Coppola's proposed reductions to O&M and capital do not make logical sense. He testified that had the company made an additional $49.4 million in contributions to the fund, assuming a 7% rate of return, the additional funding would have provided an annual return of $3.5 million, of which the O&M portion is about $2.5 million, rather than the $4.2 million adjustment recommended by Mr. Coppola. Additionally, he testified, had the company funded the OPEB plan with the additional amounts, it would have increased the company's working capital requirements, which in turn would have increased the revenue deficiency by over $5 million. Finally, Mr. Vogel reviewed the Commission's decision in Detroit Edison's rate case, Case No. U-16472, cited by Mr. Coppola. He testified that the Commission rejected the proposed rate adjustments recommended by Mr. Coppola in that case, but did direct Detroit Edison to include in the trust funding amounts sufficient to cover both the OPEB expense and the capitalized OPEB recognized in rates. He testified that the company is prepared on a going forward basis starting in 2012, to fund its external trusts accordingly.

In its initial brief, the company notes that Staff and the company agree on the projected expenses for employee benefits. The company relies on Mr. Kops's rebuttal testimony to address the Attorney General's proposed reductions.[293] In its reply brief,

[293] See initial brief, pages 88-93.

Consumers notes that the Attorney General's brief addresses only Mr. Coppola's direct testimony, and cites the Commission's order in Case No. U-16472 (October 20, 2011, pages 62 and 64) as rejecting the Attorney General's position.[294]

In his initial brief, the Attorney General cites Mr. Coppola's testimony and recommendations. Addressing Mr. Vogel's rebuttal testimony, he cites Mr. Coppola's surrebuttal testimony, arguing that there is no support on the record for Mr. Vogel's claim that the company would increase the funding in the future using the depreciation amounts as well.[295]

In its brief, Staff indicates that it adopted the company's projection, and supports the company's commitment to fund its external OBEP trusts with the amount of OPEB expense and the capitalized OPEB reflected in rates on a going forward basis.[296] A review of the Commission's order in Case No. U-16472 indicates that the Commission addressed a similar situation in Detroit Edison's recent rate case:

> The commission has consistently taken seriously the need for utilities to fund the costs associated with pensions and OPEB. It is evident on this record that Detroit Edison has failed for many years to properly fund the external trust for these benefits. Contrary to its arguments, Detroit Edison has been collecting in its rates an amount related to depreciation of the capitalized amount and a return on the undepreciated capitalized amount as well as the deferred costs, in other words, revenues related to OPEB. Nowhere in the record is there an indication that Detroit Edison contributed to the external trusts these related revenues.[297]

Here, Consumers acknowledges that it has failed to fully fund the external OPEB trust. Like Detroit Edison, it argues that prior Commission orders did not require it to do so, although the Commission rejected these arguments in Case No. U-16472. While the

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[294] See Consumers reply brief, pages 40-41.
[295] See Attorney General brief, pages 38-41.
[296] See Staff brief, page 41.
[297] See October 20, 2011 order, page 63.

Commission declined to require Detroit Edison to make up for past underfunding at this point in time, the Commission put the company on notice that it may be required to do so in the future. Although Consumers has committed to the funding level the Commission required of Detroit Edison in that case, this PFD recommends that the Commission provide the same direction to Consumers that it provided in that case: 1) on a going forward basis, the Commission directs the utility to place in an external fund an amount sufficient to cover OPEB costs recognized in its rates, without reduction for capitalized or deferred amounts; 2) Consumers may be held responsible for making up the difference when the liability becomes due.[298]

8. Smart Grid/AMI

Ms. Trumble testified to the company's proposed Smart Grid/AMI O&M expense projection, as shown in Exhibit A-48. Since then, as noted above in section IV, the company has revised its timetable.[299] In its initial brief, the company indicates that the revised schedule for deployment of the smart meters reduces the company's O&M requirements during the projected test year from $7.072 million to $4 million.[300] In its reply brief, the company notes that Staff and the company are in agreement.[301] Staff's brief also acknowledges that the expense projections should be reduced to the $4 million level.

The parties arguing that the Commission should reject all funding for the project present the same arguments discussed in section IV above.

[298] See October 20, 2011 order, Case No. U-16472, page 64.
[299] See Exhibit S-17.
[300] See Consumers initial brief, pages 93-94.
[301] See Consumers reply brief, pages 38 and 44.

Although recommending that the company's request for deployment of the SG/AMI project be deferred, this PFD recognizes that the Commission and Staff have encouraged the company to continue to evaluate technologies and options for the project, to continue to refine the company's business case, and to develop strategies for customer education, etc. For this reason, it appears that some level of O&M funding for the project is appropriate. Given the company's plan to delay meter installation until September, and its concomitant reduction in projected spending, it appears that the bulk of the proposed spending for the test year would not relate to deployment.[302] For this reason, this PFD recommends the $4 million expense allowance be included in the test year operating expense projection.

9. Rate Case Expense

Mr. Coppola testified that the company has entered a cycle of filing frequent rate cases, filing 6 since November 2008, or an average of one every 6 months, including both electric and gas operations. He testified that he requested information on the costs the company incurs in filing a rate case, and as presented in Exhibit AG-15, the company indicates it does not keep any information on these costs. His Exhibit AG-10 contains his "ballpark" estimate of $900,000. He testified that a number of regulatory commissions have disallowed portions of rate case expenses, and recommended that the Commission allow the company to recover only 50% of such expenses. On this basis, he recommended a $450,000 reduction to the company's test year O&M forecast.

[302] Exhibit S-17 shows only $101,000 related to meters, modules and communications O&M.

Further, he asked the Commission to require the company to keep records of its rate case expenses.[303]

Mr. Rasmussen testified in rebuttal regarding rate case expenses.[304] He testified that the company has incurred little, if any, incremental expense related to rate cases since 2008 PA 286, and further that the company's Rates Department has half the number of employees it had in 2003. He also testified that it would be burdensome to require the company to keep detailed records to monitor rate case expenses, and interfere with the company's efforts to keep O&M expenses low.

In his brief, the Attorney General relies on Mr. Coppola's testimony and recommendations.[305] Consumers addresses the Attorney General's proposal in its initial brief at pages 123-124, and in its reply brief notes that the Attorney General relies on Mr. Coppola's testimony with no analysis of the company's rebuttal testimony.[306]

This PFD finds that the Commission has not recognized a reduction in O&M expense allowances for rate case expenses in the past. Instead, the Commission's O&M expense allowances have reflected the company's historical expenditures adjusted for inflation. While Mr. Coppola refers to the frequency with which companies are filing rate cases as a rationale for the change, this PFD notes that many past rate cases consumed significantly more resources and transcript pages than the present cases.[307]

[303] See 4 Tr 693-697.
[304] See 3 Tr 113.
[305] See Attorney General brief, pages 36-38.
[306] See reply brief, page 43.
[307] See, e.g., August 17, 1984 order, Case No. U-7650, page 4.

C. **Other Expenses/Taxes**

1. Depreciation and Amortization Expense

Staff and Consumers disagree over the depreciation and amortization expense calculation. Ms. Rolling presented the company's calculation, reflected on line 23 of her Exhibit A-8. She testified that she used the new depreciation rates adopted in Case No. U-16054, applied to the average projected test year depreciable plant balances.[308]

Mr. Krause testified on behalf of Staff. [309] He indicated that the company used two methods to determine depreciation. He testified that the method used in Exhibit A-8, Schedule C6 is based on calendar year 2012, rather than the projected test year. Instead, he testified, Staff recommends the company's plant model method, which uses the old depreciation rates for the period October through June 2012, and new rates for the period July 2012 to September 2012.[310] He testified that Staff's calculation using the company's plant model was modified to reflect Staff's use of actual September 30, 2011 balances and to accept the capital expenditure adjustments Staff recommended, including adjustments to the company's generation and distribution capital expenditure projections, and including removal of the Clean Coal Plant costs. Staff's resulting $334,869,000 depreciation and amortization expense amount is shown on line 17 of Exhibit S-3.

In her rebuttal testimony, Ms. Rolling asserted that Staff's use of the company's plant model resulted in the use of depreciation rates that are outdated for the projected

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[308] See 3 Tr 178.
[309] See5 Tr 1078-1079.
[310] See Rolling, 3 Tr186-187.

test year.[311] She explained that the company's plant model incorporates the old depreciation rates for the nine months October through June 2012. She cited the June 28, 2011 order in Case No. U-16054, approving a settlement agreement revising depreciation rates effective with the Commission's final order in the next general rate case. Presenting a revised calculation based on the projected test year of $354,595,000, excluding Clean Coal Plant costs, in Exhibit A-8, Schedule C-6a, she testified that the combination of Staff's lower plant balances and outdated depreciation rates understate the level of depreciation expense that will occur by $20.4 million.

Staff's brief, pages 44-45, indicates that the company's analysis "likely has merit", but will require further analysis when the Commission's decisions are made regarding plant balances, the Clean Coal Plant, and capital expenses.[312] Consumers reply brief acknowledges that the depreciation expense may change depending on the Commission's decisions on capital expenditures and the Clean Coal Plant, but reiterates its position that the new depreciation rates should be used.[313]

This PFD notes that the company's projected test year began October 1, 2011. At that point in time, the company was required to book depreciation expenses using the "old" depreciation rates approved in Case No. U-10754 (July 24, 1998 order). The company has not established that when a Commission order is issued in this case, it will revise depreciation expenses booked in 2011, or booked prior to the June 2012 date by which a Commission order is expected in this case. The company has not testified that its plant model is inaccurate in continuing to use the old depreciation rates to June

[311] See 3 Tr 186-188
[312] See also Staff reply brief, page 26.
[313] See Consumers reply brief, pages 34-35.

2012. Because the company will use the higher rates only after the Commission issues an order in this case, the test year expenses should reflect a blend of the old and new depreciation rates appropriate for the test year. Note that the company chose the test year in this case. Also, the Commission used a combination of old and new rates in setting the level of depreciation expense in Detroit Edison's recent rate case, Case No. U-16472. Thus, this PFD finds that Staff's approach has more merit and should be followed in setting depreciation expense for this case.

2. Allowance for Funds Used During Construction

Consumers' Exhibit A-8, Schedule C-11 calculates an AFUDC amount of $2,042,000;[314] Staff calculated an AFUDC amount of $1,933,000 as shown on Exhibit S-3, Schedule C-11.[315] Consumers and Staff appear to be in agreement that the relatively minor difference between each party's calculation of the appropriate AFUDC offset is due to differences in their recommended returns on equity.[316] This PFD thus recommends that the Commission calculate AFUDC consistent with the CWIP balances and rate of return it adopts in setting final rates in this case.

3. General Taxes

The only dispute between the parties regarding general taxes involves the projected property tax expense. Mr. Vogel presented the company's estimated property tax expense for the projected test year, as shown in his Exhibit A-49. He explained the steps in the company's estimation of its 2012 property tax liability based on the

[314] See Rolling, 3 Tr 178.
[315] See Krause, 5 Tr 1079-1080.
[316] See Consumers reply brief, page 35; Staff brief, pages 45-46.

company's estimated tax liability for 2011, plus the estimated tax on 2011 estimated plant additions. He explained how the test year expenses are derived from prorated 2011 and 2012 estimated tax expenses. He also estimated the resulting property tax rate of 0.013038733.[317]

Mr. Coppola recommended an adjustment to the company's property tax expense to remove taxes associated with the SAP software, consistent with his recommendation that all SAP costs be removed from rates.

Ms. Talbert testified that the property tax expense should be reduced by $1.36 million for the test year, as shown on Exhibit S-3, Schedule C-7, based on Staff's $208 million reduction in the CWIP balances. She testified that Staff accepts the company's estimated property tax rate, and method of calculation.[318]

In rebuttal, Mr. Vogel testified that his calculations did not rely on projected spending for 2012, and also that Staff's CWIP reductions were largely for pollution control equipment, which is exempt from property taxes. Mr. Vogel also testified in rebuttal to Mr. Coppola's recommended adjustment, citing MCL 211.9d to support his testimony that the company did not include property taxes associated with the SAP software because it is exempt from property tax.[319]

Staff argues in its brief that its recommended $1.358 million adjustment should be adopted, indicating that Staff followed the company's methodology in multiplying 50% of the CWIP adjustment by the property tax rate Mr. Vogel computed. The company responds in its reply brief that Staff has not provided a rationale for reducing

[317] See 3 Tr 614-616.
[318] See 5 Tr 1189.
[319] See 3 Tr 630.

the property tax expense in response to Mr. Vogel's unequivocal statement that CWIP was not included in the company's test year property tax expense calculation.[320]

This PFD recommends that the Commission accept Consumers' projected property tax expense. It appears that Mr. Vogel's tax amount of $136.2 million in line 10 of Exhibit A-49 is based on 2010 actual and 2011 estimated plant-in-service, rather than CWIP balances, which he uses to determine a test year average property tax rate.[321]

4. Income Taxes

Mr. Vogel presented the company's estimated income tax expenses for the projected test year, as shown in Exhibit A-8, Schedules C8 and C9. He testified that the 2010 health care reform legislation increases the company' s tax liability by eliminating the deduction for Medicare Part D subsidies, which will now be subject to 35% federal and 6% state income taxes.[322] He estimated the amount of these additional expenses in his calculations and no party challenged them.

He also testified to changes in State tax law from the Michigan Business Tax to a 6% corporate income tax, which applies roughly but not exactly to the same income as the federal income tax. As a result of these changes, the company is also requesting accounting authorizations as discussed in section VII below.

Ms. Talbert testified that Staff accepts the company's methodology for determining test year state and federal tax liability, with adjustments to reflect Staff's lower O&M expense levels, depreciation and amortization expense, and property tax

[320] See Consumers reply brief, pages 35-36.
[321] See Exhibit A-49, page 4.
[322] See 3 Tr 616.

expense.[323] Ms. Talbert also testified that Staff recommends a $1.99 million adjustment to the company's tax calculation to reflect a domestic production activity deduction (DPAD). She testified that Staff's adjustment is based on information the company provided in response to an audit request, and on the adjustment adopted by the Commission in Case No. U-15645.

She also testified that Staff's calculation explicitly incorporate the pro forma interest and interest synchronization adjustments that were separately stated prior to the Commission's November 4 decision in Case No. U-16191. Staff's projected income tax expenses are shown in Exhibit S-3, Schedule C-8.

Mr. Vogel testified in rebuttal that the deduction is not available to the company, either on a separate company basis or as part of CMS Energy. He testified that Consumers does not have the option of filing as a stand-alone company. Moreover, he testified that if the hypothetical deduction were recognized, there is uncertainty as to how it should be estimated. [324]

In its brief, Staff indicates that because its recommendations have changed, its recommended federal and state tax expense projections need to be recalculated. Staff addresses Mr. Vogel's rebuttal testimony by arguing that the DPAD adjustment has been made in the company's last two rate cases.

This PFD recommends that the Commission accept Staff's DPAD adjustment. As Staff argues, it appears that the Commission has adopted this adjustment in the last two rate cases for the company. The company did not address the Commission's past

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[323] See 5 Tr 1189-1192.
[324] See 3 Tr 626-629.

decisions in its briefs. This PFD finds that Consumers has not presented sufficient evidence to justify elimination of this adjustment.

D. Adjusted Net Operating Income Summary

The following chart summarizes the recommended adjustments to Staff's Adjusted Net Operating Income. As noted in section IV above, consistent with the rate base adjustments and return on equity recommendation, depreciation expense and AFUDC may also require adjustment.

Staff ANOI (Exhibit S-3, Sched C1)		$453,717,000
O&M Expense Adjustments:		
Fossil/Hydro base O&M	$3,800,000	
Weadock	$2,600,000	
SmartGrid/AMI	$3,072,000	
Forestry	($190,000)	
Total		$9,282,000
Income Tax Effect (x .41)		($3,805,620)
General Tax Adjustment		($1,358,000)
Income Tax Effect (x .35)		$475,000
Total Company ANOI		$458,310,000

VII.

OTHER REVENUE RELATED ISSUES

A. Revenue Decoupling Mechanism

Consumers request for a revised revenue decoupling mechanism was presented by Mr. Ruhl.[325] He testified that the current method based on average use per customer does not recognize the migration of customers between rate schedules, which could introduce an element of distortion as customer counts change over the period. Instead, he recommended a mechanism that simply compares the nonfuel rate revenues approved in the rate case to the actual revenues over the period. At the annual reconciliation, he proposed that the total amount of shortfall or surplus would be allocated to each rate schedule based on their share of non-fuel revenue as approved in the rate case. He presented Exhibit A-41 to illustrate this method. He further testified that the new mechanism should begin with the first full billing month following the Commission's final decision in this case, with the current RDM in place until that date.

Ms. Smith presented Staff's recommendations.[326] She testified that Staff is recommending the same RDM for Consumers Energy that the Commission recently adopted for Detroit Edison in Case No. U-16472. Under this RDM, which Staff describes as a modified Simple Revenue Tracker with Energy Optimization Caps, there are seven conditions on the sales tracker:

> 1) for full service customers, revenues reflected in the calculation are equal to total rate schedule revenue less customer charge, fuel and purchased power, and other surcharges; 2) for retail open access

[325] See 3 Tr 239-242.
[326] See 5 Tr 1173-1180.

> customers, revenues reflected in the calculation are equal to total rate schedule revenue less customer charge revenue and other surcharges; 3) all months associated with the projected test-year are excluded from true-up; thus, (4) the first annual reconciliation period commences with the first month following the end of the general rate case projected test-year; 5) operation of the mechanism terminates upon utility implementation of new rates (whether or not self-implemented pursuant to 2008 PA 286) and must be re-approved in the next general rate-case order; 6) the allocation of the qualifying revenue shortfall will be by rate class (i.e. residential, primary, and secondary); weather normalized sales data should be used to calculate over- or under-recovery amounts during the reconciliation period.[327]

In addition, Staff proposes that the amount of recovery be limited by caps pegged to the statutory Energy Optimization targets. Staff believes this RDM will remove the utility's disincentive to promote energy optimization, while balancing the risks to the company and ratepayers:

> In addition to reflecting a balancing of risk exposure, the RDM permits the utility to break out from the annual cycle of general rate-case filings by providing a reasonable alternative. Subsequent to the projected test-year, customers bear the risk of RDM surcharges (albeit limited to a level defined by the maximum reasonable EO induced revenue loss).[328]

In rebuttal to Staff's proposal, Mr. Ruhl explained the company's view that the limitations in Staff's proposal could severely reduce the amount of decoupled revenue that would be available to fund company operations. Regarding the E.O. based cap, he testified that the resulting adjustments may not fully reflect the variations from rate case sales levels that are actually experienced, and would diminish the effectiveness of the cap.[329] He testified that both elimination of the cap, and increasing the covered revenues to include system access charges would make Staff's proposal acceptable.

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[327] 5 Tr 1177-1178.
[328] See 5 Tr 1178.
[329] See 3 Tr 263-264.

Mr. Selecky testified that the company's proposed RDM would compensate the company for sales declines that result from various factors including economic recession or increased power prices, and could potentially expose customers to frequent and large rate increases:

> The rate uncertainly created by an RDM adversely impacts customers by exposing them to a significantly higher level of financial risk, making it much more difficult for them to manage their energy budgets and plan for future power requirements.[330]

He also characterizes the RDM as frustrating customer efforts to voluntarily conserve. He further recommended that if the Commission approves continuation of the RDM, large industrial customers should be exempt. Also, he recommended the following modifications: that the mechanism be restricted to compensate the utility only for sales declines that are a direct result of Energy Optimization program implementation; that surcharges be authorized only if actual sales by rate class decline; the RDM should compensate the company only for lost volumetric revenues, rather than customer charges and other non-volumetric rate components; rate class subsidies must not be created; and surcharges should be limited to independently verified sales reductions resulting from Energy Optimization implementation. [331]

Mr. Ruhl disputed that the RDM reduces customer motivation to reduce energy costs, and disputed Mr. Selecky's concern that the RDM creates rate volatility and uncertainty. Regarding Mr. Selecky's concern that an RDM would expose customers to potentially large rate surcharges, Mr. Ruhl characterized this concern as unsupported by analysis or data. Mr. Ruhl also testified that the company disagrees with Mr.

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[330] 4 Tr 807.
[331] See 4 Tr 805-812.

Selecky's proposed modifications. Regarding Mr. Selecky's recommendation that large customers be exempt from the RDM, Mr. Ruhl testified that he does not support this recommendation except for Rate E-1:

> A large number of industrial customers have shown a strong interest in our EO programs and associated rebates and for this reason I don't feel they should be excluded from the RDM without valid reason. Rate E-1, on the other hand, has a fixed rate and is a large customer that should not be subject to the surcharge or credit. [332]

Mr. Coppola recommended modifications to the company's proposed RDM.[333] He characterized the company's proposal as "a 100% revenue guarantee", and recommended that the Commission use a variant of the RDM adopted for Detroit Edison in Case No. U-16472, but based on weather-adjusted usage per customer rather than total sales. Mr. Ruhl's rebuttal reiterated that the company recommends moving away from average use per customer to avoid distortions caused by customer migrations.[334]

Mr. Gorman recommended that the Commission terminate the RDM and not replace it. First, he contended that Consumers did not establish that it met the reliability standards the Commission identified as a condition of the RDM in Case No. U-15645. He also characterized the RDM as a departure from traditional ratemaking, and testified that it erodes the efficiency incentives created by traditional ratemaking, transfers utility business risks to customers, reduces the utility's motivation to be responsive to the needs of its customers; and creates unnecessary rate volatility and uncertainty.[335] In testifying that the RDM reduces the utility's risk, he testified that the company's

[332] See 3 Tr 267.
[333] See 4 Tr 725-727.
[334] See 3 Tr 268.
[335] See 6 Tr 1250-1264.

authorized return should be reduced if it has such a mechanism. He also testified that the RDM results in rates that are not based on the cost of service, as the variance between actual revenues and rate case revenues are allocated on the level of base rate revenue from the prior rate case. When losses occur due to customer migration or loss of customers within a class, he testified that unjust results are reached when class revenues are held constant. Citing examples from Maine and Washington, he testified that negative experiences with rate volatility led those states to cancel RDMs in the 1990s.

Mr. Townsend testified that the company's proposed RDM goes beyond addressing the utility's disincentive to engage in energy efficiency programs, but protects the company from risks that customer counts and usage may change for any number of reasons.[336] Acknowledging that he did not find the current RDM to be reasonable, Mr. Townsend testified that the company's proposal is worse, and likened it to single-issue ratemaking. He objected to company's failure to quantify the impact of customer migrations under the current RDM, and further recommended that customers that self-direct their energy efficiency activities under 2008 PA 295 be exempt on the basis that such customers fund their own energy efficiency.

In rebuttal testimony, Mr. Townsend reviewed the testimony of Ms. Smith, Mr. Selecky, Mr. Gorman, Mr. Coppola, and Mr. Zakem.[337] He testified that Staff's more limited proposal also addresses issues far beyond energy efficiency, recommending against any revenue tracker, and supported Mr. Gorman's recommendation that the Commission reject the tracker and cancel the RDM. "At a minimum," he testified, "the

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[336] See 3 Tr 357-360.
[337] See 3 Tr 365-369.

RDM should be canceled for larger commercial and industrial customers."[338] Mr. Townsend also objected to Mr. Coppola's recommendation to retain a use-per-customer metric, arguing that this metric is not appropriate for large customers because factors other than efficiency can have a significant impact on their usage.

Mr. Ruhl's rebuttal testimony asserted that: "Revenue decoupling was contemplated and authorized by the Michigan Legislature, and therefore it is an appropriate ratemaking mechanism to be considered by the Commission in this case."[339] He further added to his earlier testimony that excluding customers who self-direct from the RDM would create inequality, and would harm the company's ability to fully recover its authorized revenues given that costs are allocated to all customers.

Mr. Zakem recommended that any RDM have separate adjustments for recovery of revenue related to power supply and delivery, with adjustments for recovery only of delivery revenues applied to ROA customers. Also, he recommended that surcharges and credits be allocated on a total company rather than rate class basis, even if the amounts are determined on a class basis, and recommending the use of actual sales as the metric for determining whether a surcharge or credit is due, rather than usage.[340]

Mr. Ruhl responded to Mr. Zakem's proposal to create separate RDM adjustments for power supply and delivery, arguing that the company's proposal to allocate reconciliation amounts based on authorized revenue for the ROA class means the ROA class will be allocated a smaller share of any shortfall or surplus.

[338] See 3 Tr 368.
[339] See 3 Tr 269.
[340] See 6 Tr 1223-1236.

In its briefs, Consumers relies on Mr. Ruhl's testimony to explain the company's position and address the positions of the other witnesses.

Staff relies on Ms. Smith's testimony as well as the Commission's decision in Case No. U-16472. Staff further explains the Energy Optimization caps on recovery as a 1.5% cap on the qualifying revenue shortfall by rate class for the first annual reconciliation period, and a 3% cap in subsequent periods. Staff addresses Mr. Ruhl's rebuttal testimony by explaining its view that the purpose of the RDM is not to eliminate broad revenue risks, but to reduce the risk of revenue losses due to Energy Optimization programs. Staff argues that its caps allow the company room for significant expansion beyond the statutory Energy Optimization targets. Staff also argues that customer charges should not be included because customer charge revenues are not impacted by implementation of the Energy Optimization programs. Finally, Staff recommends that the Commission terminate the current pilot effective with the date Consumers self-implemented rates in this case, December 8, 2011.[341]

In its reply brief, Staff responds to the arguments of ABATE and the Attorney General challenging the lawfulness of the RDM.[342]

Energy Michigan argues in support of Staff's proposal that it fully and fairly addresses the concern of Energy Michigan that ROA customers not be subject to an RDM surcharge or credit that contains power supply costs, and resolves other concerns as well.[343]

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[341] See Staff brief, pages 90-95.
[342] See Staff reply brief, pages 35-41.
[343] See Energy Michigan reply brief, page 8.

This PFD recognizes that Mr. Gorman and other intervenor witnesses identified significant concerns for the Commission to consider in adopting an RDM.[344] Nonetheless, the Commission has repeatedly concluded that RDMs are important to reduce utilities' disincentives to undertake energy efficiency measures. Given the Commission's expressed preference for an RDM, Staff's proposal alone among the competing RDMs presented in this case significantly limits the positive and negative risk associated with changes in sales between rate cases that are transferred from the utility to ratepayers. Based on the Commission's decision in Case No. U-16472, this PFD concludes that it would be inconsistent with that decision to reject Staff's RDM proposal in this case. Nonetheless, there are two caveats to this conclusion. First, this PFD assumes that the cap also operates symmetrically, that is, that revenue shortfall and revenue excess are both capped by the 1.5% to 3% limit. Either way, this should be clarified to avoid confusion in the reconciliation.

And second, rather than characterize this RDM as "permanent", this PFD recommends that the Commission consider this an alternate pilot approach, and continue to monitor for reasonableness both the use of sales in the RDM rather than usage, and the operation of the cap. With the cap in place, other circumstances such as changes in the economy or customer reactions to price increases could still create sales shortfalls. Should exogenous factors other than energy efficiency reduce sales levels, the company's incentive to pursue energy efficiency measures could be diminished. Nonetheless, this risk-mitigation aspect of the cap has positive values for ratepayers, since it minimizes the potential surcharge, and to the company, in that, if it is

[344] See, e.g., Hemlock brief, pages 9-20; ABATE brief, pages 14-19; Kroger brief, pages 8-12.

symmetrical, limits the company's exposure to refunds. The point, however, is that the potential impacts associated with the cap are difficult to determine, and for that reason this PFD recommends that the Commission indicate a willingness to revisit that issue in the company's next rate case.

B. <u>Uncollectible Expenses Tracker Mechanism (UETM)</u>

Consumers is requesting a tracking mechanism for uncollectible expenses. Mr. Ruhl presented testimony in support of the company's request, testifying that the purpose of the tracker is to protect both the company and its customers from deviations in actual uncollectible expenses from the rate case projections.[345] He referred to Mr. Jones's testimony that the company expects increased uncollectible expense levels in response to the anticipated reduction in federal LIHEAP funding as the impetus for the request. He further testified that the proposed tracker would carry with it a 5% deadband around the projected expense level, such that actual uncollectible expenses within the deadband would not be subject to adjustment, but expenses above or below that 5% deadband would trigger a rate hearing and surcharge or credit to collect or refund the amounts outside the deadband. He testified that the company proposes to reconcile the tracker on an annual basis. He presented Exhibit A-42 to illustrate the operation of the tracker.

Dr. Nwabueze testified to Staff's policy recommendations regarding trackers. He explained that Staff recommends that the Commission deny further requests for

[345] See 3 Tr 243-244.

trackers, including the company's proposed UETM and choice tracking mechanism, based on 2008 PA 286:

> Prior to the recent proliferation of trackers, Staff had recommended, and the Commission had adopted, the use of three or five year averages for most volatile costs. While a three or five year average does eventually fulfill cost recovery by the utilities for volatile costs, a three or five year average, or any multi-year average, does not allow the utilities current recovery of volatile costs. Although a three or five year average was a sufficient ratemaking method for cost recovery when utilities would only file rate cases every three or five years, our utilities have deemed such averaging techniques inadequate for current cost recovery since they have begun filing annual rate increase requests. Therefore, the utilities requested, and the Commission approved, trackers for recovery of volatile costs. Since the purpose of the requested trackers was to allow the utilities current cost recovery of volatile costs, which, by definition, can be accomplished through the use of projected costs for a future 12 month period and the self-implementation provisions of PA 286, Staff recommends that the Commission rely on PA 286 as the vehicle to enable the utilities to recover current volatile costs.[346]

He further elaborated on the impacts of 2008 PA 286:

> The ability to file annual rate cases, which Consumers Energy has so far taken advantage of every year, afford the utility with the opportunity to adjust very quickly to actual or projected changes in circumstances, thus mitigating the likelihood of an extreme negative outcome related to variations in Choice sales (or other factors for that matter). In addition, the ability to self-implement up to its revenue deficiency as early as the fist day of a given test period mitigates the likelihood that the utility will experience an actual revenue deficiency in any given test period.[347]

Mr. Gorman testified that the company's proposal should be rejected because it eliminates the incentive for Consumers to aggressively manage its uncollectible expense, and allows for surcharges through reconciliations without a demonstration that rate changes are justified, e.g. due to other offsetting cost decreases or revenue

[346] See 5 Tr 1110.
[347] See 5 Tr 1113-1114.

increases. He also testified that the impacts of the recovery of uncollectible shortfalls could move rates away from the cost of service.

Mr. Ruhl and Mr. Rasmussen testified in rebuttal to Dr. Nwabueze, Mr. Coppola and Mr. Selecky.[348] Mr. Ruhl testified that trackers are appropriate in limited circumstances:

> These are when the cost item is 1) volatile, 2) difficult to predict with any level of certainty, 3) a significant amount, 4) and not in the control of the utility.

He testified that the trackers the company recommends fit these criteria and would work in a symmetrical manner. He further responded to Mr. Selecky's testimony by indicating that because the trackers would only apply to components evaluated during a rate case, and allow recovery in line with what was authorized, they would not undermine the Commission's ability to evaluate Consumers' rates based on the totality of the utility's costs and revenues. Mr. Rasmussen emphasized the volatile nature of the uncollectible expense, and the other criteria identified by Mr. Ruhl. Further, he testified that the self-implementation provisions of 2008 PA 286 do not protect a utility from costs that deviate from rate case assumptions in a projected test year:

> Allowing from just 3 months between a rate order and the filing of the next general rate case could mean a lag of up to 15 months before new rates could be implemented to remedy an unforeseen, significant cost increase or decrease.[349]

In its brief, Consumers also cites Staff's comments from Case No. U-15645 supporting a tracker.[350]

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[348] See 3 Tr 103-105; 6 Tr 271.
[349] See 3 Tr 104.
[350] See Consumers brief, pages 107-108.

This PFD recommends that the Commission reject the proposed uncollectibles expense tracker. While this category of expense may be volatile, the company has not shown it to be materially more volatile than when the Commission terminated the tracker in Case No. U-16191. Indeed, the company filed this case within 7 months of the termination of the tracker, and thus did not have a full year's worth of experience without a tracker to present to the Commission.

C. Forestry Tracker

Mr. Peloquin testified in support of a tracker-type mechanism for the company's forestry expenses.[351] He testified that the company's requested forestry expense for the projected test year in this case is 31% above the company's request in Case No. U-16191. He testified that he supports a significant tree-trimming program if the monies are actually spent, but expressed his concern that the company will not consistently spend budgeted amounts, due to pressure on utility management to increase earnings coupled with the ease of reducing tree-trimming expenses. He further testified that a forestry allowance subject to refund nullifies most of the company's financial incentives to reduce tree-trimming. Acknowledging that the Commission rejected the tracker in place for these expenses in Case No. U-16191, Mr. Peloquin recommended an alternate mechanism that requires the expenditures to be subject to refund, subject to a calendar-year reconciliation and a rolling over-under recovery, with refunds, if any, awarded every three years. Mr. Peloquin's proposal would allow the company to use monies not expended in one year in the next year.

[351] See 6 Tr 1548-1551.

In his rebuttal testimony, Mr. Rasmussen explained the company's opposition to Mr. Peloquin's proposal, arguing that forestry expenditures are not volatile, are not difficult to predict, and are not beyond the company's ability to control, and thus are not good candidates for a tracker.[352] Note too that Dr. Nwabueze testified to Staff's concerns with trackers generally, although his testimony was not specifically directed to Mr. Peloquin's proposal.

Because the Commission just eliminated the forestry tracker in Case No. U-16191, and because at the same time the Commission significantly increased the company's forestry expense allowance, this PFD recommends that the Commission reject MCAAA's recommendation, and allow time to evaluate the company's forestry operations in the absence of a tracker.

D. Choice Tracker

Mr. Ruhl testified that the company is not proposing an electric choice sales tracker in this case, except "in the event the Michigan Legislature increases the existing 10% cap on electric choice sales prior to the issuance of a final order in this case."[353] In that event, Mr. Ruhl testified, the company requests a tracker without an incentive mechanism or deadband.

The witnesses testifying in opposition to the uncollectible tracker also generally opposed a choice tracker. Mr. Gorman testified that if the ROA cap is increased, the

[352] See 3 Tr 105; Consumers reply brief pages 722-73.
[353] See 3 Tr 240.

resulting cost changes could be significant, should be addressed in a rate case, and could not reasonably be addressed through a tracker.[354]

This PFD concludes that since Consumers has not cited legislation modifying the existing cap, its request is not ripe for consideration in this PFD.

E. SG/AMI Accounting

Mr. Jones testified regarding guideline 5 adopted in the Commission's November 4 order in Case No. U-16191, indicating potential conflicts with accounting requirements and seeking clarification from the Commission.[355] He testified that the Uniform System of Accounts requires that electric meters be accounted for as plant in service, whether in inventory or installed. Meters installed in the pilot phase, he testified, are nonetheless being used to provide service to customers, and should therefore be accounted for as plant-in-service. He testified that because guideline 5 could be interpreted as requiring accounting for new meters in CWIP even when they are used to bill customers, Consumers seeks clarification regarding the apparent inconsistency. Likewise, he testified that AFUDC policies adopted in Case No. U-5281 require a project to have costs over $50,000 and a six-month construction requirement to qualify for AFUDC, while meters, communications equipment, and computer equipment do not meet the six-month construction requirement.

He also testified that the company follows normal retirement and depreciation practices regarding the retirement of the meters being replaced by the Smart Grid/AMI meters, citing the Uniform System of Accounts, Account 108. He explained that since

[354] See 6 Tr 1268-1269.
[355] See 4 Tr 969-972

the company uses a remaining life technique when determining depreciation rates, the undepreciated costs of these meters would be collected through future depreciation rates. The company also seeks confirmation that this accounting is appropriate and consistent with the guidelines.

Finally, he testified regarding the company's capitalization of software modification costs, indicating that company's policy is to capitalize these costs if the modification results in "additional functionality", and that capitalized software costs are closed to plant-in-service when the software is available for its intended use. Citing Uniform System of Accounts, Account 107, he also sought clarification that following this accounting is not inconsistent with guideline 5.

Mr. Birkam testified that Staff agrees with the accounting procedures identified by Mr. Jones.[356] He further testified that Staff recommends that the software, computer hardware, communications equipment, and meters be in separate subaccounts with their 300 plant subaccounts as defined by the Uniform System of Accounts. He also recommended that other distribution plant retirements relating to the Smart Grid/AMI be identified by the company when it would expect to be booked in CWIP or Plant in Service: "Staff would expect this to occur when the Company reaches the stage of Smart grid implementation where more than just AMI meters will be installed on its system."[357]

[356] See 5 Tr 1037-1042.
[357] See 5 Tr 1041.

This PFD recommends that the Commission clarify that the accounting for Smart Grid/AMI capital expenditures, and the related retirements, should be in accordance with the testimony of Mr. Jones and Mr. Birkam.

F. Tax Accounting

Mr. Vogel also testified regarding accounting changes the company is seeking approval for as a result of changes in tax laws.[358] Ms. Talbert testified that Staff recommends that the Commission grant the company's request.[359] In its recent order in this docket and others, the Commission addressed the pending tax issues for utilities as follows:

> The Providers and the Staff agree that the Commission should apply its long-standing regulatory policy for deferral accounting and full normalization ratemaking to both the state and federal tax law changes wrought by the PPACA and the MCIT, as delineated in the February 8, 1993 order in Case No. U-10083. The Commission agrees with the parties and approves the following treatment for the re-measurement of deferred taxes resulting from the state and federal tax law changes: (1) deferral of the net income statement effects caused by the changes in tax law through the establishment of a regulatory asset or liability in accordance with Accounting Standards Codification (ASC) 740 and 980, and Case No. U-10083; (2) full normalization of the deferred tax effects of the changes in tax law on a prospective basis in accordance with Case No. U-10083; and (3) reversal of the deferred income statement effects of the changes in tax law over a period reasonably related to the reversal of the underlying book-tax basis differences, using the Average Rate Assumption Method (ARAM), the Reverse South Georgia Method (RSGM), the straight line method, or the period prescribed by law.
>
> This leaves the issues of the specific amortization method for the income tax regulatory assets or liabilities. The Providers identified three accounting options – ARAM, RSGM, and straight line – for re-measurement of deferred income. While the Staff expresses a preference for RSGM, the Commission finds that, because Michigan regulated

[358] See 3 Tr 620-621; and see Consumers brief at page 99.
[359] 5 Tr 1191-1192.

> utilities differ greatly in their size, structure, and the types of computer programs in use for tracking their assets, they should have the flexibility to choose among these accounting options for re-measurement of deferred income.[360]

For these reasons, this PFD recommends that the Commission approve the company's request as consistent with the Commission's February 15, 2012 order.

G. SNF Fees

MCAAA argues that Consumers has not been reasonable and prudent in compromising claims by and against the federal government regarding fees for spent nuclear fuel (SNF) disposal, and urges the Commission to implement "regulatory remedies" to protect ratepayers. MCAAA presented the testimony of Mr. Peloquin and Mr. Callen addressing these issues. Acknowledging his long-time involvement with this issue, Mr. Callen's testimony reviews the history of the Nuclear Waste Disposal Act, the "contract" between the federal government and utilities for the waste disposal, the federal government's breach of its obligation to take SNF starting in 1998 followed by its recent decisions to abandon plans to take SNF at all, litigation across the country resulting from the federal government's actions, and the fees collected from Consumers' ratepayers and the Commission's decisions in Case Nos. U-15645 and U-16191 regarding those fees. Mr. Callen testified that because the federal government has repudiated its obligation to take SNF, utilities are able to pursue damage claims against the federal government, including claims for refunds of past fees:

> [A]ll or most utilities with cases filed before the Court of Claims have or are preserving the right to collect past, ongoing, and future damages, and also to seek refund of past fees paid to the federal government under the Standard Contract. . . . It would appear that CECo had a valid claim for

[360] February 15, 2012 order, Case No. U-16794 et al., pages 2-3.

past and ongoing damages and for refunds of all SNF fees, at least for the period until it sold and transferred its nuclear facilities and SNF sites to Entergy Nuclear Palisades LLC (ENP) on or about April 10, 2007.[361]

With regard to Consumers' actions, Mr. Callen testified:

> CECo has presented no information as to why it has recently proceeded to enter into a settlement with the federal government that would: (1) pay $163 million collected from ratepayers for SNF disposal when the federal government has refused to undertake SNF disposal and has now repudiated its own standard contract; (2) to effectively waive future law suits every six (6) years for incremental damages arising from the federal default; (3) to waive or fail to preserve the right to seek refund or restitution of past paid SNF contract fees, in contrast to the approach by other utilities to preserve said remedy; and (4) to protect ratepayer interests." 7 Tr 1600-1601.

Mr. Callen recommended that the Commission take several actions to protect ratepayers, including a rate reduction to refund the fees to ratepayers.

Mr. Peloquin testified that Consumers used $163 million in SNF fees that it was not obligated to pay to the U.S. as inducement to obtain $30 million in refunds attributable to its Big Rock nuclear plant claim, and he argues the money should be refunded to ratepayers over a ten year period.

In its brief, Consumers responds:

> At page 23 of its June 10, 2008 order in MPSC Case No. U-15245 the Commission stated: "Consumers' sale of Palisades allowed it to *fully exit* the risky nuclear generation industry." (Emphasis added). The pre-1983 DOE Liability is not included as a component of the projected test year rate base or in the capital structure. 3 Tr 169, 170, 477-478. Indeed, there are no costs included in expenses sought by Consumers Energy or which will be incurred during the test year related to spent nuclear fuel or the DOE Liability. MCAAA's efforts to interject such issues in this case should be rejected for the reasons set forth in Consumers Energy's Motion to Strike.

[361] See 7 Tr 1601.

In that motion, the company argued, inter alia, that its decisions regarding its rights and obligations relative to the federal government are not relevant to any issue to be determined in this rate case. The company argued that it was not seeking to recover any SNF fees in this rate case, and had not included the DOE liability in its capital structure. The company noted that it had filed an application in Case No. U-16861 "seeking approval to refund to customers $23.3 million recovered in litigation with the federal government."[362]

Staff argues that the Commission should reject the MCAAA's rate remedies, and argues:

> [T]he Commission has found on more than one occasion that Michigan utilities did not act imprudently when they paid the per kWh fee to the [DOE] as required by the utilities' contracts with DOE. These Commission findings have been affirmed as being lawful by the Michigan Court of Appeals. For instance, in In re Application of Detroit Edison Company, 276 Mich App 216; 740 NW2d 685 (2007), the Michigan Court of Appeals noted its previous rejection of the claim that the Commission had acted unlawfully when it found that payment of these fees was imprudent [sic] and held:
>
>> We note at the outset of our analysis of MEC's and PIRGIM's appeal that these same plaintiffs challenged the PSC's identical determination regarding spent nuclear fuel (SNF) issues in In re Application of Indiana Michigan Power Co . . . In Indiana, we rejected each and every legal challenge MEC and PIRGIM raise here. Therefore, for the reasons and on the grounds set forth in our decision in Indiana and under the doctrine of collateral estoppel, we reject all of plaintiff's arguments regarding the SNF-related issues and hold that the PSC properly rejected all of MEC/PIRGIM's SNF-related challenges.
>
> Now that Consumers has shed ownership of any nuclear plants, its ratepayers will obtain the benefit of avoiding any further liability with respect to disposal of spent nuclear fuel and other risks associated with nuclear plant ownership. And, in Case No. U-16861, the Commission will determine the appropriate refund liability associated with the Company's

[362] See motion, pages 4-5.

> settlement of its lawsuit against the DOE for damages associated with DOE's failure to take the spent fuel rods that also involved Consumers' decision to pay its pre-1983 DOE liability as part of its overall settlement of that case.[363]

In its reply brief, Consumers characterizes its settlement as a management decision that is beyond the Commission's ability to review, citing *Union Carbide v Public Service Comm*, 431 Mich 135, 148 (1988), and argues that requiring a refund of amounts paid to the federal government is prohibited by principles of retroactive ratemaking:

> Requiring a refund of amounts which were lawfully collected from customers pursuant to lawful Commission rates and subsequently paid to the federal government would be a retroactive rate adjustment and would be confiscatory and unlawful.[364]

This PFD recognizes that in view of the large amount of money at stake, the Commission should be concerned with whether the utility has acted reasonably and prudently in regarding its handling of this matter, but believes that in Case No. U-16191, the Commission provided a forum to evaluate the reasonableness and prudence of the company's settlement agreement. In its March 17, 2011 order, the Commission directed Consumers to file within 60 days of signing a settlement "a case requesting review of its settlement with the United States Department of Energy." In issuing that order, the Commission stated:

> Within 60 days of entering a settlement, Consumers shall file an application in a new docket that will address the disposition of the settlement proceeds and permit all interested parties to weigh in on the reasonableness and prudence of the agreement.[365]

[363] Staff reply brief, page 29-30.
[364] See Consumers reply brief, pages 76-77.
[365] See Order, pages 7-8.

Contrary to the company’s arguments regarding management prerogative and retroactive ratemaking, Consumers is accountable to the Commission and ratepayers for its disposition of a substantial asset, moreover an asset that, although not yet placed in a trust fund, was arguably impressed with a constructive trust, to be preserved for the benefit of ratepayers. Had Consumers negligently entrusted $163 million in ratepayer funds to an incompetent money manager, clearly the Commission would be concerned. Likewise, if the company unreasonably and imprudently waived claims for return of some or all of the money. Nonetheless, while Consumers acknowledges paying $163 million to the federal government, it is unclear on this record what claims, if any, for return of those funds or other SNF fees have been waived by the company's actions.

Respectfully, Staff's analogy to the *Indiana Michigan* case is inapposite, since that case involved a request that the Commission require the utility to withhold funds from DOE that were legally required to be paid at that point in time, in order to alter the respective bargaining positions of the utility and DOE regarding litigation over DOE's alleged breach of its contractual obligations. Here, the funds at issue were not legally required to be paid to the federal government in the absence of the settlement agreement, but had already been earmarked to fund an external trust. Moreover, the Commission has concluded that the reasonableness and prudence of the company’s settlement agreement must be determined.

For these reasons, this PFD recommends that the Commission clarify that questions of the reasonableness and prudence of the company’s settlement with DOE, including any decisions it made to compromise claims against the federal government, are to be determined in Case No. U-16861, and find no further rate remedies are necessary at this time.

VIII.

REVENUE DEFICIENCY SUMMARY

In accordance with the foregoing recommendations, this PFD estimates that Consumers' base revenue deficiency on a total company basis for the test year is computed as follows:

Rate Base	$7,307,000,000
Rate of Return	6.68%
Income Required	$488,108,000
Adjusted Net Operating Income	$458,310,000
Income Deficiency	$29,798,000
Revenue Multiplier	1.6367
Revenue Deficiency	$48,770,000

IX.

COST OF SERVICE

A. Production and Transmission Cost Allocation

Both Consumers and Staff used the "12 CP 50/25/25" method to allocate production and transmission costs, as adopted by the Commission in Case No. U-15645 and U-16191.

Mr. Selecky and Mr. Gorman both recommended changes to the "12 CP 50/25/25 method" for allocating production and transmission costs.[366] Mr. Selecky testified that the Commission should use the "4 coincident peak" or "4CP" method rather than the "12 CP" method for the first component of the "50/25/25" method to allocate production and transmission costs. Mr. Selecky testified that this "12 CP 50/25/25" method understates the consequences of peaking behavior, arguing that Consumers must design and build its system to accommodate peak demand, and due to economic dispatch, the last unit dispatched is the more expensive. Although ABATE prefers a "pure" 4CP allocator, it also argues that replacing the "12 CP" peak demand allocator with the "4CP" peak demand allocator in the 50/25/25 formula would provide a better correlation to cost causation. Mr. Selecky also testified that use of this method would not violate MCL 460.11(1), because it would not allocate additional costs to primary customers.

Mr. Gorman recommended that the "12 CP" allocator for the peak demand component of the 50/25/25 method be replaced with the "4 CP" allocator for production

[366] See Selecky, 4 Tr 782-785.

costs, and that the “12 CP” allocator exclusively be used to allocate transmission costs.[367] He presented a chart showing the monthly system peaks used in Consumers’ cost of service study, testifying that the non-summer peaks are 61-75% of the annual system peak demand in August, and argued that “[i]t is reasonable, then, that the allocation of production capacity costs to customers should place substantially more emphasis on summer peak demand loads rather than on non-summer non-peak loads.”[368] He also presented a 2009 report of Consumers addressing its summer capacity plan to support his argument that summer peaks are causing Consumers to acquire generation capacity.[369] Regarding transmission costs, he testified that Consumers is assessed transmission service charges on the basis of its contribution to the Michigan Electric Transmission Company’s 12 monthly coincident peak demands, and the allocation to the utility’s customers should match 12 CP this allocation.

Mr. Keaton testified in rebuttal that Consumers supports use of the 4CP method rather than the 12 CP method to determine the peak demand component of the 50/25/25 allocator for production costs and supports Mr. Gorman’s proposed “pure 12 CP” allocation for transmission costs, but also presented information regarding the impact of making the changes.[370] Mr. Ruhl also testified to the company’s belief that “it is in the best interest of all customers to keep industrial rates as low as possible in order to foster business development in the state” to explain the company’s support for these changes.[371] And Mr. Ruhl presented Exhibit A-69 to show the rate impact of these changes on each customer group. Consumers reviews this testimony in its brief, and in

[367] See Gorman, 6 Tr 1273-1250; Exhibit HSC-1.
[368] See 6 Tr 1245.
[369] See 6 Tr 1246.
[370] See 3 Tr 404-406.
[371] See 3 Tr 261-262.

its reply brief argues that the change to the 4 CP 50/25/25 allocator for production costs and the pure 12 CP allocator for transmission costs is "appropriate".[372]

ABATE's briefs rely on Mr. Selecky's testimony to argue that production costs should be allocated on the basis of a pure 4CP allocator, or at a minimum replacing the 12 CP component of the 50/25/25 allocator with the 4 CP method. ABATE also cites Mr. Keaton's rebuttal testimony.[373] In its reply brief, ABATE adopts Mr. Gorman's recommendation regarding transmission cost allocations, arguing that the unrebutted testimony shows that FERC uses the 100% 12 CP method to allocate transmission costs.[374] ABATE argues that Staff's opposition to its proposal "flies in the face of the legislative mandate to move rates so that they equal the cost of providing service." ABATE also argues that Staff does not dispute the concept that its proposed methodologies to allocate costs moved rates close to cost of service but only that the prior methodologies had been approved.[375]

Hemlock's briefs review Mr. Gorman's testimony and likewise argue that his recommendations further the principle of aligning costs based on cost causation.[376] The Municipal Coalition also argues in favor of revising the allocation method.[377]

Staff's brief argues that the Commission should retain the method adopted in Case Nos. U-15645 and U-16191.[378]

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[372] See Consumers brief, pages 124-125, reply brief, page 79.
[373] Note that ABATE's brief mistakenly refers to Mr. Kehoe's testimony, see ABATE brief, page 3.
[374] See ABATE reply brief page 3
[375] See ABATE reply brief, page 2.
[376] See Hemlock brief, pages 3-9.
[377] See Municipal Coalition brief, pages 5-7; reply brief, pages 2-3.
[378] See Staff brief, pages 57-58.

This PFD recommends that the Commission continue to use the recently-approved 12 CP 50/25/25 method, on the basis that none of the parties have presented new evidence on this matter or provided any other compelling reason for the Commission to revise its method. Note that none of the parties advocating a change in the allocation method have addressed the Commission's recent decision in Case No. U-16191, or addressed the analyses presented to the Commission when it adopted the current production and transmission cost allocation methods in Case Nos. U-15645 and U-16191. Only the Municipal Coalition addresses the Commission's decision in Case No. U-15645, and it essentially reargues its view that the Commission's decision was legally wrong.

A review of the Commission's decision in Case No. U-16191 shows that the Commission was well aware of the METC transmission cost allocation.[379] The Commission clearly rejected the intervenors' assertions, now echoed by Consumers, that their proposed methods of production and transmission cost allocation better align rates with the cost of service:

> The Commission found that the Legislature has mandated the use of the 50/25/25 allocation method for both production and transmission, thus precluding Hemlock's 100% demand argument, and that 12CP is a better fit with the required 50% weighting of peak demand than 4CP. The Commission again finds that the intervenors' proposals will not better ensure rates that are equal to the cost of service.

B. <u>Customer Assistance Costs</u>

Mr. Selecky also testified regarding the allocation of "customer assistance costs". Citing the Commission's recent decision in Detroit Edison's rate case, he testified that in

[379] See November 4 order, page 69.

Case No. U-16472, the Commission allocated customer assistance costs by number of customers, rather than by billed sales.[380] He also testified that this approach is consistent with the NARUC cost allocation manual, which recommends classifying these costs as customer-related. Additionally, he testified that these costs should be allocated in the same manner as uncollectible expenses. In his rebuttal testimony, Mr. Townsend testified that he supported this position.[381]

Mr. Keaton did not address this in his rebuttal testimony.

In its brief, Staff argues that Consumers and Detroit Edison do not follow all of the same cost allocation methods. It further asserts that Detroit Edison has used a customer-based allocator for its "customer assistance" category of costs for some time, but also used jurisdictional cost of service to allocate "uncollectible expenses." For Consumers, Staff argues that when taken together, the combined allocation of customer assistance expense and uncollectible expense is spread appropriately between the rate classes even though they are not individually allocated on the same basis.[382]

Staff further asserts that the principal cost component of the "customer assistance" cost is the LIEEF funding, now the Vulnerable Household Warmth Fund established by 2011 PA 274. Staff argues that altering the cost allocator in light of the statutory obligation to ensure that these costs are removed from rates by September 2012, is unnecessary and could complicate compliance with the statutory requirement.

[380] See 4 Tr 785-786.
[381] See 6 Tr 369-370.
[382] See Staff brief, pages 59-62. Implicit in Staff's argument is that Consumers allocates uncollectible expenses on the basis of customer numbers, in contrast to Detroit Edison, which uses jurisdictional cost to serve.

ABATE argues in its brief that Consumers supports its proposal, citing its Exhibit AB-15. In its reply brief, it accuses Staff of making misleading statements regarding the allocation of uncollectible expense, and attaches two pages from Mr. Putnam's workpapers that it acknowledges are not in the record of this proceeding to show how uncollectible expenses are allocated on the basis of customers. Further, it argues that Staff did not address the "directive" from an "authoritative source", the NARUC Electric Utility Cost Allocation Manual, that these costs be allocated on the basis of customers.[383] Kroger supports ABATE's position, also citing the Commission's decision in Case No. U-16472.[384]

This PFD recommends that the Commission defer consideration of the allocation of this cost item to the company's next rate case, retaining the current allocation method in the meantime. This record does not establish what the NARUC manual referenced is, whether it indeed constitutes a "directive" as ABATE argues, and what other changes might need to be made to cost allocations to be consistent with that "directive." ABATE also seems to misunderstand Staff's analysis. It appears that Staff is arguing that for Detroit Edison, an allocation of customer assistance on the basis of customer numbers is balanced by the allocation of uncollectible expense based on jurisdictional revenue, while for Consumers, the allocation of uncollectible expense is already made on the basis of customer numbers. Thus, although ABATE recognizes a relationship between uncollectible expenses and customer assistance, it is not at all clear that the allocation methods should be identical. Indeed, there is no obvious choice for costs of this nature,

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[383] See ABATE reply brief, pages 3-4.
[384] See Kroger brief, page 13.

because by definition the customers who cause uncollectible expenses are not the customers who bear those costs.

Finally, as Staff argues, the specific customer assistance costs at issue need to be removed from rates at the end of the test year, and there is little point in complicating that removal. In the next rate case, the parties can provide information and analyses addressing the appropriate allocation of both customer assistance and uncollectible expenses, so that any appropriate balance is maintained or established.

C. Income Tax Items

Mr. Putnam testified that Staff recommends allocation of federal and state income taxes on the basis of pretax net operating income, rather than on the basis of total revenues as in the company's cost of service study. Mr. Putnam further testified that this change is consistent with the approach adopted in Case No. U-16191. In his rebuttal testimony, Mr. Keaton agreed.[385] In the absence of dispute, and recognizing that the Commission ruled on this issue in Case No. U-16191, this PFD recommends that the allocator be modified as recommended by Staff.[386]

D. Critical Peak Summer Purchased Power

Mr. Putnam testified that the allocator used for Critical Peak Summer Purchased Power should be modified. He explained that the company had created a new allocator to allocate fuel expense during the hours of 2 p.m. through 6 p.m. on weekdays from June through September. He testified that this "allocation factor 107" should also be

[385] See 3 Tr 406.
[386] See November 4 order, pages 69-70.

used to allocate Critical Peak Summer Purchased Power costs. Mr. Keaton agreed with this in his rebuttal.[387] In the absence of dispute, this PFD recommends that the allocator be modified as recommended by Staff.

E. Staff Request for Cost of Service Study Information

Mr. Putnam also testified to Staff's request that the company be directed to provide additional information regarding its cost of service study allocations:

> In the Company's current filing there is no testimony or exhibits detailing the development of allocation factors. The company is using a three year average of what it calls historical data by the Company does not include any information regarding the development of the historical data. Because of the complexity related to the development of allocation factors, it makes it extremely difficult if not impossible for the Staff and other intervening parties to determine the legitimacy of the allocation factors through audit and discovery requests alone. But requiring the company to explain, in great detail, the development of the allocation factors, it will significantly reduce this burden.[388]

He further described the information Staff seeks:

> The Staff recommends that in all future rate case filings the Utility should be required to file testimony and exhibits and provide work papers, which explain and illustrate in great detail, how the historical and test year allocation factors were developed. This should include, but is not limited to, describing which rate class allocation factors are based on samples and which rate class allocation factors are based on a census. For the class allocation factors that are developed from a sample, the Utility should illustrate through testimony, exhibits and work papers, with all the appropriate statistical information, how the samples were expanded to properly represent the classes as a whole as well as how they were transformed into allocation factors. For the class allocation factors that are developed from a census, the company should illustrate how the census was transformed into allocation factors.[389]

This PFD recommends that the Commission grant Staff's request.

[387] See 3 Tr 406.
[388] 5 Tr 1136.
[389] See 5 Tr 1135.

X.

RATE DESIGN AND TARIFF ISSUES

A. Residential Rate Subsidy-Amount

The parties generally agree that the total amount of the residential or "skewing" subsidy remaining in rates after Case No. U-16191 is $69 million, and that this amount should be reduced by $39 million in this case, leaving $30 million to be addressed before October 5, 2013.[390]

Mr. Ruhl initially testified that if the company does not file another rate case before that date, it would file a tariff to accomplish the remaining deskewing, but on cross-examination, he was not sure what procedures the company would follow to accomplish that, deferring to the company's legal team.[391] This PFD recommends that rather than authorize the company to file and use a tariff in the future, the Commission consider requiring the company to make the tariff adjustments part of its tariff filing in this case, so that the parties would have an opportunity to comment on the revised numbers.

B. Residential Customer Charge ("system access charge")

Consumers proposes to increase the residential customer charge or "system access charge" from $6 to $7 per month. Mr. Ruhl testified that this represents movement toward a cost-based system access charge as reflected in Mr. Keaton's cost

[390] See Ruhl, 3 Tr 226-227.
[391] See 3 Tr 278.

of service study.[392] Mr. Pung testified that Staff does not support the residential monthly customer charge increase, noting that a residential customer charge was adopted for the first time in 2008 in Case No. U-15245, and was set at $6.[393] Staff further argues in its brief that nothing in 2008 PA 286 requires the customer charge to be cost-based.[394] Consumers argues that customers understand and pay flat system access charges for all types of services, including gas, cable, and telephone.[395]

This PFD finds that Staff's concern is reasonable; numerous rate changes have the potential to cause customer confusion, and at a time when the company has recently implemented other rate design changes for residential customers, including the summer and winter pricing differentials, and is in the process of eliminating rate skewing, the company has not established that it is reasonable to change the customer charge as well.

C. <u>Other Residential Rate Discounts</u>

Consumers and Staff agree that the Commission should retain the Senior Citizen and Residential Income Assistance discounts. The only difference is the level of the charge, given that the parties disagree on the amount of the residential customer charge as discussed above. Because this PFD recommends that the residential customer charge remain unchanged, this PFD also recommends that the Senior Citizen and Residential Income Assistance discounts remain unchanged.

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[392] See 3 Tr 230, 259-260.
[393] See Pung, 5 Tr 1123.
[394] See Staff brief, pages 66-67.
[395] See 3 Tr 259; and see Consumers brief, page 130.

Consumers and Staff both agree that the monthly Life Support and Farm credits should be decreased from $4.90 to $3.80. In the absence of dispute, this PFD recommends that the Commission adopt these reductions.

D. <u>Non-Residential Rate Discounts</u>

For the non-residential rate categories, Consumers proposes to continue to phase out the discounts for the Municipal Pumping Service and Furnace/Metal Melting Service, although the company is proposing a metal melting pilot program, discussed below. Consumers also proposes to retain the economic development discounts, Rate GED and Rate E-1.[396] Staff supported this proposal and no party opposed it.

Only the Municipal Coalition opposed the reduction in the Municipal Pumping Service Credit. Mr. Holt testified that to the financial burden on municipalities from electric rate increases in recent years.[397] He testified that the City of Wyoming spend significant amounts of money on peak load reduction to achieve savings based on the prior rate schedules that were then discontinued in Case No. U-15245. He further testified that since that 2008 rate case, the City has seen a 60% increase in summer costs and 28% increase in winter costs, with additional rate increases attributable to the reduction in the pumping credit proposed in this case. The Municipal Coalition requests that the Commission create a separate rate class for municipalities, and in the meantime, continue the pumping credit.

Mr. Ruhl testified in rebuttal that treating municipalities as a separate rate class would result in an estimated higher cost of service than reflected in the rates

[396] See Ruhl, 3 Tr 227-228.
[397] See 4 Tr 648-662.

municipalities are now paying, based on their low load factors. Staff in its brief concurs in Mr. Ruhl's analysis.

This PFD finds that the requirements of 2008 PA 286 require that the municipal pumping credit be phased out. Based on Mr. Holt's testimony, and with the hope of shedding more light on this issue in a subsequent case, this PFD recommends that the Commission endorse Mr. Ruhl's offer to demonstrate to the Municipal Coalition the potential results of the rate treatment it is seeking.

E. Residential and Other Discounts-Allocation

The company allocated the remaining $30 million residential rate subsidy on the basis of power supply cost of service, and the other rate discounts on the basis of **total cost of service**. Mr. Pung testified that Staff recommends that the discounts be allocated as in past cases based on total energy, also indicating that by changing the allocation method, the company is shifting additional financial burden to the residential customer class.[398] Neither Mr. Keaton nor Mr. Ruhl identified this change in allocation in their direct testimony.

Mr. Selecky testified that the discounts should be allocated on the basis of total cost of service, and also that a portion of the discounts should be allocated to lighting and unmetered classes.[399] He presented Exhibit AB-3 to shows the revenue targets he developed based on his allocation of the skewing and rate discounts, based on the company's requested revenue deficiency; Exhibit AB-10 show the revenue targets he developed based on Staff's revenue deficiency and his changes in the allocations of

[398] See 5 Tr 1124.
[399] See 4 Tr 788-790; 821-826.

these discounts as well as the allocation of the customer assistance costs discussed above. Mr. Townsend testified in rebuttal that he supports this allocation.

In his rebuttal testimony, Mr. Ruhl testified:

> Mr. Pung proposes to continue using electric sales as the basis for allocating skewing and discounts since (i) it is the currently approved method and (ii) using the cost-to-serve as the basis would shift more of the burden to the residential class. Alternatively, Mr. Selecky proposes to allocate skewing and discounts to all rate schedules, excluding education, based on the total cost-to-serve. . . . With an emphasis on encouraging business growth in the state, the Company believes that using the cost-to-serve to allocate skewing and residential discounts is more equitable.[400]

He further explained what he meant by equitable:

> It's true that residential customers will pay more by using the cost-to-serve to allocate the skewing and discounts. However, by spreading it over a much larger customer base the impact to any particular residential customer is minimal. . . . *By reducing the skewing and discount burden on business customers it frees capital that can be reinvested into expending their operations in Michigan*.[401]

He presented the following calculation in support of this statement:

> For example, assume that changing the skewing and discount allocation method from electric sales to the cost-to-serve shifts $10 million annually from the large business classes to the residential class and that the residential and large business classes are composed of 1.5 million and 5,000 customers respectively. From this example, the impact to a residential customer is approximately $0.56/ month . . . On the other hand, the savings to a business customer is much more substantial at $167,000/month (10,000,000/12*5,000).[402]

Staff also argues that changing the allocation method shifts an additional financial burden to the residential class, which is already affected by the Act 286 rate

[400] See 3 Tr 258.
[401] See 3 Tr 259 (emphasis added).
[402] See 3 Tr 258.

realignment in addition to the recent and proposed rate increases.[403] Staff specifically addresses Mr. Ruhl's rebuttal testimony, arguing that even if the allocation change would have only a small impact on any particular residential customer, that the burden as a whole to residential customers is overly burdensome. Staff further argues that, while there is no single right way to allocate these discounts, rate stability is promoted by consistent allocation.

This PFD recommends that the Commission reject the proposed changes in the allocation of these discounts. The Commission has previously addressed this issue, and the proponents of the change have not established a compelling reason to revise the previously accepted allocation method. Note that while Mr. Ruhl’s rebuttal testimony suggests significant savings of $167,000 per month to each of the hypothesized 5,000 large customers, his arithmetic overstates the result of the formula he presents: $10,000,000/12*5,000 = $167 per month.[404] Moreover, he does not analyze the impact on other small customers.

F. School and Educational Institutions

Mr. Ruhl explained that the company complies with the statutory requirement to offer cost-based rates to schools and other educational institutions by providing that all self-identified educational institutions on normal full service or ROA rates have

[403] See Staff brief, pages 64-66.
[404] As noted above, the effects of time constraints on the parties’ ability to review, analyze and present useful information to the Commission are obvious in this case.

schedules that eliminate any discounts that would otherwise be allocated to the group.[405] No party opposed Mr. Ruhl's testimony on this topic.

G. Rate GPD Rate Design

Mr. Selecky testified that the distribution rates established for each of the three voltage levels within Rate GPD are not based on the cost of service study results for each of those levels. He testified that Consumers developed revenue targets for the entire rate schedule, not the different voltage levels, which he designates CVL1, CVL2, and CVL 3 corresponding to the company's designations of High Voltage Subtransmission, Subtransmission, and Primary, respectively:

> It appears from the review of the workpapers that Consumers essentially designed the CVL1 rates and then simply increased the energy charges by a constant increment of 0.2¢/kWh for both CVL2 and CVL 3 customers. By making this adjustment, the charges for CVL2 were much higher than they needed to be and the CVL3 lower.[406]

Mr. Ruhl agreed in his rebuttal testimony that the rates he designed recover the cost to serve by rate schedule, plus the allocated share of discounts, but the rates by voltage level deviate from the cost study results. He explained:

> Although adhering strictly to the cost study is ideal when designing rates, it is also generally accepted to deviate from the cost study to design fair and equitable rates that maintain price signals and mitigate rate shocks to any particular group of customers. The Company has considered rate shock and appropriate price signals in developing its rates. See 3 Tr 248.

He further explained that in looking only at the distribution piece of the Rate GPD rate design, Mr. Selecky missed the bigger picture; when the power supply deviations are also considered, the CLV1 and CLV2 customers pay $6.6 million and $2.5 million below

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[405] See 3 Tr 228.
[406] See 4 Tr 794.

the amounts identified in the cost study, while the CLV3 customers make up that shortfall. He presented Exhibit A-68 to show this.

Staff supports the company's rate design, and takes issue with its assertion that its rate design is inconsistent with 2008 PA 286, arguing that the statute requires only that rates for each rate class be based on cost of service. Staff agrees with Mr. Ruhl's testimony that the obligation in designing rates is to send correct price signals and recover the costs associated with the customer class.[407]

Mr. Townsend also testified regarding the Rate GPD rate design, taking issue with the billing components:

> [C]ontrary to good rate design practice, Consumers not only recovers a portion of its GPD distribution costs through an energy charge – the Company recovers the majority of its distribution costs in this fashion. And alarmingly, Consumers is proposing in this case to make it more extreme: For Voltage Level 3 customers, Consumers is proposing to reduce the distribution demand charge by 31.5%, while increasing the distribution energy charge by 56.4%. Not only are these changes in rates radical in degree, the movement is in exactly the wrong direction. Distribution-related costs should not be recovered through an energy charge in the first instance, much less increase by over 50%. Such a change, of course, would improperly shift costs to higher-load-factor customers within Voltage Level 3 of Rate GPD.[408]

He presented Exhibit KRO-1 to show his recommended rate design to recover all distribution-related costs from the distribution demand charge.

Mr. Ruhl testified in rebuttal that the practical design must take into account economic breakeven points between rate schedules GP and GPD, as well as the voltage levels between rates:

> Mr. Townsend supports the decrease in the System Access charge from $400 to $100 for the GPD rate schedule. While supporting the decreased

[407] See Staff brief, pages 127-128.
[408] See 3 Tr 351.

> System Access charge reduction of 75% the balancing of the rate design is inevitable. The decreased System Access charge will result in an increased demand or distribution charge as proposed in the rate design. Consumers Energy proposed to recover this reduction in the distribution charges due to reasons stated above, mainly the economic breakeven points between voltage levels and rate schedules.[409]

Consumers relies on Mr. Ruhl's testimony in its brief. Staff also opposes Kroger's proposed rate design for Rate GPD, relying on Mr. Ruhl's testimony.[410]

In its initial brief, Kroger explains why customers with higher load factors subsidize the costs of lower-load-factor customers when the demand charges are set below cost and energy charges are set above cost, and argues that is what Consumers' rate design for CLV3 does. Kroger asserts that the company's filing masked this effect, because it only illustrated the impact of its proposed rate design at the 50% load factor level. Kroger attaches Mr. Townsend's Exhibit KRO-1 (NT-1) to its brief.

Mr. Townsend also took issue with the Rate GPD power supply charges, contending that for an overall rate increase of 1.9% for CLV3, the company proposed to reduce the summer on-peak demand charge by 5.9%, while increasing the summer off-peak energy rate by 31.4%. Mr. Townsend testified:

> Strange as it may seem, after carefully inspecting the proposed rate, the only explanation that occurs to me is that Consumers is exhibiting an unwarranted penchant for expressing rates and rate differentials in round numbers. Forcing rate components and rate differentials to fit round numbers is causing unreasonable impacts on individual rate components. . . Obviously, when demand charges are forced to even-dollar amounts, energy charges must be changed to accommodate the proposed revenue requirement – whether or not the change in the energy rate per se is cost-justified.[411]

Mr. Ruhl testified in rebuttal regarding the power supply charges as follows:

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[409] See 3 Tr 251.
[410] See Staff reply brief, pages 31-32.
[411] See 3 Tr 355.

> As Mr. Townsend suggested, the Summer and Winter Off-peak rates have increased by 31.4% and 10.9% respectively for GPD, VL3. They have also increased for GPD VL1 and VL2 consistent with VL3. The relationship between Off-peak and On-peak compared to the MISO market Off-peak and On-peak trends is considered when designing these rates. The MISO data analyzed is trending towards the Off-peak and On-peak rates becoming less differentiated. The proposed increase in Off-peak energy rates over the entirety of the GPD rate schedule reflects the market rates more closely and sends the appropriate price signals relative to market conditions.[412]

In its reply brief, Kroger argues generally that Consumers did not provide support for its assertions regarding the economic breakeven points, and has not directly responded to Mr. Townsend's testimony.

Based on a review of this record, this PFD recommends that the Commission follow the rate design advocated by Consumers and Staff for the Rate GPD, recognizing that it is important and can be difficult to design rates to maintain economic breakeven points. Nonetheless, this PFD notes that there is little evidence on this record to determine how the appropriate economic breakeven points have been determined. None of the witnesses testified directly to the underlying analysis. And as Mr. Townsend testified, Consumers presented the effects of its rate design for the different voltage levels for a 50% load factor customer only, making it difficult to determine the effects, incentives, and equities of what can be significant changes in cost. Moreover, many of the changes in the company's rate design for this rate are very large in juxtaposition to the rate increases to be recovered from the class. Given the Commission's recent reduction in the number of rate classes, this PFD recommends that the Commission require the company to present information for this rate class regarding its analysis of economic breakeven points between the voltage levels and relative to other rates, and

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[412] See 3 Tr 251.

for this and all rate schedules, a detailed explanation of factors such as MISO trends that the company has considered in its rate design. Note that Mr. Ruhl's direct testimony on the rate design for the Rate GPD rate class was contained in two sentences:

> The Company is also proposing to differentiate the pricing structure of energy and distribution delivery rates of Rate GP by voltage level to recognize the varying levels of cost responsibility for these customer groups. The Company is also making similar changes to the distribution delivery charges of Rate GPD voltage levels 1, 2 & 3 to recognize this difference in cost responsibility as well.[413]

As noted above, the time pressures for parties to address the company's filing identifying a significant revenue deficiency within the allotted schedule makes it difficult to also evaluate concerns regarding rate design. Once this matter reaches the Commission, it is difficult for the Commission to find time to address deficiencies in the record by requiring further hearings. By requiring the company to present more detailed information up front, that highlights and explains significant alterations in existing rates, the Commission should have a better record on which to make difficult choices regarding rate design.

H. Rate GPD Power Factor Credit

Mr. Gorman took issue with the company's proposed language implementing the power factor adjustments. He recommended a change in the tariff language to make the power factor charges symmetrical with the credits.[414] Mr. Ruhl testified in rebuttal that the intent of the power factor adjustment is not improve customer energy efficiency through the use of incentives. He testified that the company provides a credit for a

[413] See Ruhl, 3 Tr 232.
[414] See 6 Tr 1270-1273.

power factor above 89.9%, and penalties for a power factor below 80.0%, while Detroit Edison penalizes customers for power factors below 85%, with no credit for higher factors. He further testified that incremental increases above the 95% level exhibit diminishing returns, and that absent an engineering or other study, he recommended against increasing the power factor credits.[415] He also pointed out that Mr. Gorman's proposed revision eliminated the substation credit.

This PFD finds Mr. Ruhl's testimony persuasive and recommends against altering the existing power factor credit.

I. <u>GSG-2 Rate Design</u>

1. <u>Double recovery</u>

Both Mr. Selecky and Mr. Gorman testified to concerns with the potential that Consumers would recover twice for the same distribution costs under Rate GSG-2.[416] Mr. Selecky testified that customers purchasing service under both Rate GSG-2 and Rate GPD could pay a maximum demand charge under each rate that exceeds the maximum amount of load at the customer's location. Mr. Gorman provided an example of a customer with a total load of 100 MW, with 50 MW of standby service under Rate GSG-2 to back up self-generation, and 50 MW under Rate GPD. In his example, when the customer shuts down the self-generation unit for maintenance, its Rate GPD maximum demand becomes 100 MW, an unreasonable amount in comparison to the customer's needs.

[415] See 3 Tr 256-257.
[416] See Selecky, 4 Tr 797-798; Gorman, 6 Tr 1273.

Mr. Ruhl testified that “there simply isn’t any duplicative billing,” and that the billing algorithm used is the same approved by the Commission in Case No. U-16191. He provided examples showing how customers taking standby power under GSG-2 would be charged under various assumptions regarding their total load and standby service.[417] Responding to Mr. Gorman’s example, Mr. Ruhl testified that the company’s billing system will still treat the customer as receiving 50 MW firm service under Rate GPD.[418] The company and Staff rely on Mr. Ruhl’s testimony in their briefs.

In its brief, Hemlock reiterates Mr. Gorman’s concerns by providing further examples, but does not address Mr. Ruhl’s rebuttal testimony. ABATE recommends the following language be added to the tariff for clarification: “There shall be no double-billing of demand under the base rate and Rate GSG-2.”[419] Neither the company nor Staff addressed this specific proposal in their reply briefs.

This PFD recommends that the Commission require the company to add some language to its tariff to clarify the operation of the demand charge provisions, so that there is no further need for concern.

2. ROA impact

Mr. Gorman also testified to a concern that ROA customers would be required to take standby service under Rate GSG-2. Mr. Ruhl testified unequivocally that “The Company does not provide power supply to ROA customers and is not proposing to provide standby power to a ROA customer, with generation, who is being serviced by

[417] See 3 Tr 252-254.
[418] See 3 Tr 253.
[419] See ABATE brief, pages 11-12.

an alternative supplier. The proposed language added to the GSG-2 tariff is to ensure the Company properly collects revenue for delivery service provided to customers electing to install generation in order to self-supply power."[420] He further attached as Exhibit A-70, his responses to discovery providing the same clarification.

In its brief, Hemlock argues that an ROA customer should be required to use a market standby source of power supply, but does not address Mr. Ruhl's testimony. In its reply brief, it argues that the issue is not moot because the ambiguity remains in Consumers' proposed tariff provision.

This PFD recommends that the Commission direct Consumers to add clarifying language to its tariff that ROA customers are not eligible for Rate GSG-2 for their ROA load. There is no need for these ongoing disputes about how the tariffs work, when the company can resolve these issues with a well-placed sentence.

3. Substation ownership

Mr. Gorman also testified that Rate GSG-2 should be modified to include a substation ownership credit: "without this credit, substation owning customers will pay for the costs of distribution substations twice – once through the costs of owning the substation and again through the costs of substations included in Consumers' distribution rates." See 6 Tr 1277-1278. Mr. Ruhl responded that the customers already receive a substation credit:

> Currently, a $0.30 credit is provided to any customer served under GSG-2 who owns their substation in accordance with the tariff. For example, a customer taking a portion of their power under GSG-2 at the transmission

[420] See 3 Tr 255-256.

> voltage level, CVL 1, pays $0.30/kW for standby demand and receives an offsetting credit of $0.30/kW. The customer is also assessed a system access a kilowatt-hour distribution charge to recover billing and metering costs plus skewing and discounts. . . . The CVL 1 customer pays a system access charge of $100.00/month and a kilowatt-hour distribution charge of $0.003820/kWh. Although it's not entirely clear based on Mr. Gorman's testimony, it appears he is suggesting the Commission approve a $0.003820/kWh credit in addition to the existing credit and that without this credit these customers are charged twice. However, Mr. Gorman's logic is flawed in that he assumes the entire amount collected through the kilowatt-hour distribution charge is related to the substation. The Company's delivery costs are composed of metering, billing, and wires costs in addition to substation equipment. Although most of the delivery costs are recovered through the standby demand charge, a small portion is recovered through the system access and kilowatt-hour distribution charges. Moreover, the kilowatt-hour distribution charges also recovery skewing and discounts approved by the Commission.[421]

Staff and the company agree that this is the appropriate credit.[422] In its briefs, Hemlock does not address Mr. Ruhl's rebuttal testimony.[423] This PFD recommends that the Commission reject Hemlock's request for an additional substation credit.

J. <u>Metal Melting, Primary Pilot</u>

As discussed in Mr. Ruhl's testimony, Consumers is proposing a pilot rate for Metal Melting primary customers as a result of the Commission's November 4 order in Case No. U-16191. The pilot allows customers with operating flexibility to take advantage of a tiered rate structure with critical peak, high peak, mid peak, low peak, and off peak time periods.[424] No party opposed the pilot,[425] although Mr. Selecky

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[421] 3 Tr 254-255.
[422] See Staff brief, pages 71-74.
[423] See Hemlock brief, page 31.
[424] See 3 Tr 232-234.
[425] See, e.g. Staff brief, pages 70-71; Pung, 5 Tr 1125.

testified that the program could be improved by adding the interruptible credit for customers who also want to take advantage of the interruptible rate GI.[426]

Mr. Ruhl testified in rebuttal that the company's pilot already incorporates some of the savings that would be expected from an interruptible tariff, but that the proposal merits consideration for the future.[427] This PFD finds Mr. Ruhl's explanation persuasive; it is reasonable to limit a pilot program so that its results can be evaluated and the program refined if appropriate.

K. Roll-In of PSCR Base

Mr. Ruhl testified that the company is proposing to reset the PSCR base in this proceeding.[428] Staff concurs that this is reasonable. Mr. Peloquin testified that the Commission should not revise the PSCR base by using projected costs, based on his concern that the utility could use this to overrecover its costs. Mr. Ruhl testified in rebuttal that use of the projected expenses are consistent with the projected test year.[429] This PFD recommends that the Commission reject MCAAA's recommendation.

XI.

CONCLUSION

This PFD recommends that the Commission adjust the company's proposed test year revenue deficiency in accordance with the discussion above, with an authorized return on equity of 10.25%, resulting in a revenue deficiency of approximately $48.8

[426] See 4 Tr 795-797
[427] See 3 Tr 261.
[428] See 3 Tr 229-230.
[429] 3 Tr 251-252.

million on a total company basis, adopt Staff's cost of service allocations and rate design, to be applied to the final revenue requirement, and modify the tariffs and grant accounting approvals in accordance with the discussion above. In addition, this PFD recommends that the Commission call for further analysis of certain matters in future rate cases.

The parties are commended for the quality of their briefs under difficult time constraints.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

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Sharon L. Feldman
Administrative Law Judge

DATE, March 30, 2012
Lansing, Michigan
drr